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By

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Dear Readers,

Greetings for the season!

In this edition, we bring you, an article on the issue of deduction available on basis of payment in terms of Section 43B of Income Tax Act. As all of us are aware, that Section 43B allows certain expenditures as deductions only on payment basis, there always exist a question as to the meaning of 'payment'. Whether the payment made by way of issue of debentures would still qualify as 'payment' under Section 43B was recently decided by Honourable Supreme Court in the matter of MM Aqua Technologies Limited. We have surveyed the said matter right from the inception to the Honourable Supreme Court and laid down our understanding and conclusions.

The next article is on one of the recent disturbances caused by a Circular in GST laws, which was released post GST Council meeting. The Circular tried to unsettle a settled understanding of taxability of annuities in case of Hybrid Annuity Model. The unsettling of taxability, apart from the main issue also will unsettle other issues. In this article, we have coined the problem, the issue created by circular, our conclusion on the main issue and the possible issues and their solutions, if at all tax would exist.

I hope that you will have good time reading this edition and please do share your feedback. I will also urge clients to mail us topics or issues on which you want us to deliberate in our future editions, so that we can contribute to the same.

Thanking You,



Suresh Babu S
Founder & Chairman

GST

WHERE DOES THIS 'ROAD' LEAD TO – TAXABILITY ON ANNUITIES – HAM PROJECTS

Contributed by CA Sri Harsha |

The construction of road is quintessentially a primary infrastructure and boost to the national infrastructure. The construction of road and maintenance thereof, is one of the important factors to boost the national income and economic productivity. The taxation of construction of road under the service tax regime was completely exempted from tax. Though, there was a lot of confusion on the taxation of maintenance of roads under the service tax regime, the ambiguity was put into rest by creating a specific entry for exemption. This was a huge relief to the sector and the service providers, considering the huge stakes of demands.

After the introduction of goods and service tax (for brevity 'GST') in India, the construction of roads was brought under tax net attracting rate of tax of 12% with the benefit of input tax credit. The tax on construction of roads under GST regime is to essentially with a view to minimise the number of exemptions to the extent possible, thereby reducing the probability of purchases without taxes in the grey market¹. Further, the taxation of amounts collected from consumers for accessing the road, which is colloquially referred as toll, is exempted in the service tax and GST regime. Hence, in a normal scenario, where the contract for road is given to service provider with a right to collect toll and there are no other payments from the service receiver except in the form of toll to be paid by the consumers, the services provided by allowing the access to road by paying toll is exempted under the GST regime.

However, with the change in time, the nature of contracts change and as an obvious reason, the taxation would also undergo change. National Highway Authority of India (for brevity 'NHAI') is the nodal agency for overseeing the construction of highway roads and incidental activities thereof. One of the models in which the construction of highways/roads is called for tenders is Hybrid Annuity Model, colloquially known as 'HAM Project'. Under HAM, the construction shall be partly financed by Concessionaire (service provider), who shall recover its investment and costs through payments to be made by NHAI, in accordance with the terms and conditions mentioned in the contract.

The standard contract contains numerous clauses. The ones which are important for the current article are discussed. The scope of the project is normally laid, wherein the Concessionaire is obliged for construction of project as specified in terms of the contract under respective schedules. The Concessionaire is also responsible for operation and maintenance of the project and required to perform and fulfil all other obligations in accordance with the contract.

A concession in form of an exclusive right, license and authority to construct, operate and maintain the project during the construction period of 730 days² and operation period of 15 years commencing from commercial operation day is being granted to Concessionaire. A concession granted shall oblige or entitle the Concessionaire to, right of Way, access and license to the site for purposes of and to the extent conferred by provisions of the agreement, finance and construct the project, manage, operate and maintain the project, perform and fulfil all of the Concessionaire's obligations.

¹exemption on output always comes with condition of non-availment of credit which would encourage service provider to buy goods where there is no burden of input tax

²may vary from contract to contract.

NHAI grants the Concessionaire, commencing from the appointed date, leave and license rights in respect of all land comprising the site which is described, delineated and shown in the respective schedule to the agreement, on an 'as is where is' basis, free of any encumbrances, to develop, operate and maintain together with all and singular rights, liberties, privileges, easements and appurtenances whatsoever, for duration of concession period and, for the purposes permitted under the agreement, and for no other purpose whatsoever.

The project shall be deemed to be complete when the completion certificate or the provisional certificate, as the case may be, is issued under the provisions of agreement, and accordingly the commercial operation date (for brevity 'COD') of the Project shall be the date on which such completion certificate or provisional certificate is issued. The project shall enter into commercial service on completion date whereupon the Concessionaire shall be entitled to demand and collect Annuity Payments in accordance with provisions of agreement.

The project bid cost is agreed at a price selected in tender and it is agreed that the Bid Project Cost specified is for the payment to the Concessionaire shall be inclusive of cost of construction, interest during construction, working capital, physical contingencies and all other costs, expenses and charges for and in respect of construction of project, save and expect as otherwise provided in the agreement.

The agreement also states that 40% of Bid Project Cost, adjusted for Price Index Multiple, shall be due and payable to Concessionaire in 10 equal instalments of 4% each during construction period. The remaining Bid Project Cost, adjusted for Price Index Multiple, shall be due and payable in 30 bi-annual instalments commencing from 180th day of completion day in accordance with the provisions of the agreement. The Completion cost remaining to be paid, shall be due and payable in bi-annual instalments over a period of 15 years commencing from completion date referred as to 'Annuity Payments'. The first instalment of Annuity Payments shall be due and payable within 15 days of 180th day of completion date and remaining instalments shall be due and payable within 15 days of completion of each of successive six months referred as 'Annuity Payment Date'.

Each of the annuity payments due and payable during the years following the COD will be specified. The annuities are split into 30, as stated earlier and a percentage of balance cost is specified against each such annuity. The Concessionaire and NHAI agrees that all operation and maintenance expenses shall be borne by Concessionaire and in lieu thereof, a lump sum financial support in form of bi-annual payments shall be due and payable by NHAI.

Setting the Context:

In simple words, let us assume the cost for construction of road, let us say, is INR 1000 Crore. Out of the INR 1000 Crore, the Concessionaire (service provider) will be paid 40%, that is, INR 400 Crore, over a period of 730 days, in a pre-defined milestone. The balance INR 600 Crores will be paid to Concessionaire (service provider) over a period of 15 years in bi-annual instalments, known as annuities. The Concessionaire (service provider) will be eligible for the said annuity once in 180 days.

The Issue:

The issue for consideration in this article is, the taxability of the above annuity payment. It is clear that the INR 400 Crores, which is received for construction of roads is taxable at 12%. The issue that requires deliberation is the taxability of the INR 600 Crores, the annuity. Let us proceed to deliberate on the same.

The Discussion:

The taxation of annuities was not clear from day one unlike the taxability of construction of roads. As stated earlier, the service by way of access to a road on payment of toll charges is exempted vide Entry 23 of Notification No 12/2017 – CT (R). Though, the annuity is in the nature of toll, paid by NHAI instead of end consumers, the annuity was not covered clearly in the said Entry 23. The matter was taken in 22nd GST Council meeting and the press release note stated at Para 7 as 'Exemption to annuity paid by NHAI (and State Authorities or State-Owned development corporations for construction of roads) to concessionaires for construction of public roads'. Further, the detailed signed minutes of 22nd GST Council meeting vide Agenda Item 13 (iv) at Para 61 on Page 68 states as under:

61. Introducing this Agenda item, the Joint Secretary (TRU-II), CBEC stated that while toll is payment made by users of roads to concessionaires for usage of road, annuity is an amount paid by National Highway Authorities of India (NHAI) to concessionaires for construction of roads in order that the concessionaire did not charge toll for access to a road or a bridge. In other words, annuity is a consideration for the service provided by concessionaires to NHAI. He stated that construction of roads was now subject to tax at the rate of 12% and due to this, there was free flow of input tax credit from EPC (Engineering, Procurement and Construction) contractor to the concessionaires and thereafter to NHAI. He stated that as a result, tax at the rate of 12% leviable on the service of road construction provided by concessionaire to NHAI would be paid partly from the input tax credit available with them. He stated that council may take a view for grant of exemption to annuity paid by NHAI/State Highways Construction Authority to concessionaires during construction of roads. He added that access to a road or bridge on payment of toll was already exempted from tax. The Hon'ble Minister from Haryana suggested to also cover under this provision annuity paid by State – Owned corporations. After discussions, the Council decided to treat annuity at par with toll and to exempt from tax, services by way of access to a road or bridge on payment of annuity'.

As a result, a new Entry 23A, 'services by way of access to a road or bridge on payment of annuity' was inserted in Notification No 12/2017 – CT (R) with effective from 13th October 17. Accordingly, the annuities which are in the nature of services by way of access to a road are made tax free. Post this, NHAI has issued a Circular 3.3.17 dated 23.10.2017 by making reference to the above newly inserted Entry 23A, stated that there will be no GST payments on annuities. The above position was accepted by the GST Council, the NHAI and the Concessionaire (service provider). The service provider in light of the exemption granted to 60% of the bid project cost, also reversed the credits pertaining such exempted supplies in light of Section 17(2) of Central Goods and Services Tax Act, 2017.

Years passed by and to the utter shock of everyone, post 43rd GST Council meeting, which was held on 28th May 2021, a circular vide 150/06/2021 – GST dated 17th June 2021 has been issued clarifying as under:

*2.2 Services by way of construction of road fall under heading 9954. This heading inter alia covers general construction services of highways, streets, roads railways, airfield runways, bridges and tunnels. Consideration for construction of road service may be paid partially up front and partially in deferred annual payments (and may be called annuities). **Said entry 23A does not apply to services falling under heading 9954 (it specifically covers heading 9967 only). Therefore, plain reading of entry 23A makes it clear that it does not cover construction of road services (falling under heading 9954), even if deferred payment is made by way of instalments (annuities).***

The above circular has reversed the position that the annuities which were received over a period of time were exempted. In our view, since the annuities are paid in lieu of toll, we believe that the exemption under Entry 23A shall be applicable. Further, a circular cannot lay down a proposition which is contrary to the notification and the circular should give way to notification to prevail. However, post issuance of the above circular, despite of the fact, it is not capturing the true intention of the notification, it is difficult to take a stand that the said annuities are exempted considering the stakes involved. Hence, NHAI has to make a representation to GST Council to bring more clarity on the said exemption. When the NHAI and service provider are very much aware of the business model and the nature of annuities, the Circular 150/06/2021 putting the clock back and stating that exemption is not available is clearly uncalled for. The desperate tax authorities, taking clue from the above circular would come on to the service providers demanding tax on the annuities.

Assuming for a minute that the annuity is taxable, there are so many other questions which requires consideration. Some of them are as under:

- Entry 23A was inserted with effective from 13.10.17, what would be tax position for period prior?
- Annuities are payable once in 180 days over a period of 15 years, the time of supply of such annuities?
- There is also an interest element received along with annuities. Is the same also taxable?
- Credit earlier foregone, can be treated as payment of tax?

Let us take each one of the above and detail the implications:

Issue	Comments
<p>Entry 23A was inserted with effective from 13.10.17, what would be tax position for period prior?</p>	<ul style="list-style-type: none"> • Imagine there was one annuity payment between 01.07.2017 to 13.10.2017. In such case, since Entry 23A has been introduced with effective from 13.10.2017, the tax authorities would state that at the time of receipt of the annuity, the same is taxable, in light of no specific exemption. • Notification No 32/2017 – CT (R) which brought in the above Entry 23A does not specifically provide for retrospective exemption on the annuities. Hence, there is tough chance for seeking exemption for the payments which fall prior to 13.10.2017. • Hence, there should be a clarification or specific mention from the Government that the said entry is applicable with effective from 01.07.2017 to see that the annuities received prior to 13.10.2017 are exempted.
<p>Annuities are payable once in 180 days over a period of 15 years, the time of supply of such annuities?</p>	<ul style="list-style-type: none"> • There are certain tax authorities who started raising demands for the annuities immediately after the completion of construction of road. As discussed above, under the HAM projects, the construction of road gets completed typically in 730 days. However, the above construction only entails 40% of the entire project cost. The balance 60% is paid over 15 years. • The tax authorities believe that since the construction of road is completed, there is no further supply involved and accordingly the tax should be also paid on 60% of the project cost which would be received over a period of 15 years. • The same was not significant till now because, everyone was under the assumption that annuities were exempted. So, it did not really bother, the time of supply. However, in light of Circular 150/06/2021, the exemption of annuities being in question, this question occupies the centre stage.

	<ul style="list-style-type: none"> • Since services qua annuities are supplied under a contract, continuously on recurrent basis for a period exceeding 3 months with periodic payment obligations, the same shall be treated as continuous supply of services and accordingly the time of supply has to be determined in terms of Section 13 read with Section 31(5) of CT Act.³ • Section 31(5)(c) states that where payment is linked to the completion of the event, the invoice has to be raised on or before the date of completion of that event. Hence, the time of supply for the events which are linked to the completion of the event is the completion of that event and nothing else. • Since, the annuities are being paid on completion of every 180th day for a period of 15 years, the time of supply for such annuity, if being taxable, should be on the completion of 180th day and not the completion of construction of the road. • Further, to remove any sort of ambiguity, the Government using the powers under Section 2(33) should specify, HAM as one of contract which would be falling under the ambit of 'continuous supply of service'. At least this should be done, if annuities are being brought into tax net.
<p>There is also an interest element received along with annuities. Is the same also taxable?</p>	<ul style="list-style-type: none"> • Generally, the annuities are paid along with interest. The rate of interest would also be specifically mentioned in the contract. In this context, whether the said interest is also to be included in the taxable value of annuities or interest can be claimed exemption? • Entry 27 of Notification No 27/2017 – CT (R) exempts interest, if received as a consideration for services by way of deposit, loans or advances. Can the Concessionaire be said to provide an advance or loan or deposit to NHAI to the extent of 60% of the project cost and accordingly the interest earned be exempted?

³Central Goods and Services Tax Act, 2017

	<ul style="list-style-type: none"> In our view, this would be tough. The said interest is paid in order to compensate the delay in payment for the services and accordingly the said interest is to be included in the value of annuities and make it taxable, assuming, the annuities are taxable in first place. If the annuities are covered under Entry 23A, then interest would also be exempted by applying the concept of composite supply and provisions of Section 8.
Credit earlier foregone, can be treated as payment of tax?	<ul style="list-style-type: none"> This is the most challenging question. Considering the insertion of Entry 23A, all the service providers and NHAI were of the belief that the annuities were exempted. Since the annuities were exempted, it resulted in a situation, where 60% of the inputs used for construction of road are towards exempted supplies. In light of Section 17(2) of CT Act read with Rule 42 of CT Rules⁴, since part of the credits are used for making supplies which are exempted, the same were reversed while filing the annual returns. Now, if a view is brought into consideration that the said annuities are not exempted, the fate of credit which was already reversed would come into the picture. There are no provisions under GST laws to take the credit on suo-moto basis. Hence, the credit which was reversed earlier cannot be taken. If the same is not allowed, then it would leading to double taxation. One, by way of reversal of credit without allowing to utilise the same against output tax payable, two, the tax payment itself. Hence, it is important that the credit reversed should be treated as payment of tax. This view was also affirmed by Honourable Supreme Court in the matter of Eicher Motor Limited⁵. If at all there was a tax liability on the annuities, the same should be demanded only after considering the reversed credit as payment of tax.

⁴Central Goods and Service Tax Rules, 2017

⁵(1999) 2 Supreme Court Cases 361

DIRECT TAX

ISSUE OF DEBENTURES VIS A-VIS ACTUALLY PAID - SECTION 43B SUPREME COURT DECISION IN MM AQUA TECHNOLOGIES LIMITED

Contributed by CA Sri Harsha & CA Narendra |

Claiming of a deduction in respect of expenditure which are covered under Section 43Bis always a discussion point at various appellate fora. Section 43B was introduced into the Income Tax Act, 1961 (for brevity 'ITA') through the Finance Act, 1983, making it effective from April 01, 1984. The primary objective of Section 43B is to compel the assessee to discharge certain liabilities by actually making the payment in order to claim such expenditure. Earlier to this, the assessee was creating a provision and claiming the said expenditure as deduction while computing business profits, without actually paying them. The Government after observing this, has introduced the said section to allow the said expenses as deduction only if the same are being paid.

The payments covered under Section 43B inter-alia includes 'interest payable on any loan or borrowing from public financial institution in accordance with the terms and conditions of the agreement governing such loan'. This clause (d) has been inserted in Section 43B through the Finance Act, 1988 with effective from 01st April 1989.

However, it is observed that some of the assesseees are making arrangements with such institutions to convert interest liability into a fresh loan, thereby not actually making the payment of interest but deferring such liability to future by way of loan. As conversion of interest liability into a fresh loan is not an actual payment by deferment of liability, a new Explanation 3C has been inserted to Section 43B by Finance Act, 2006 with retrospective effective from 01st April 1989 which states that for the removal of doubts, it is hereby declared that a deduction of any sum, being interest payable under clause (d) of section 43B, 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. In other words, when ***any interest payable to public financial institution is converted into a fresh loan, deduction for such interest is not available at the time of such conversion and is available only when such loan (which is converted from interest) is repaid.***

In this regard, a matter has reached the Honourable Supreme Court¹ for its deliberation on Section 43B in respect of issue of debentures against the interest liability through a rehabilitation plan. In this case, let us examine the interpretation of Section 43B(d) read with the Explanation 3C in detail. For the sake of understanding of case in detail, the analysis of the case has been provided as follows:

- ❖ Study of Facts
- ❖ Conclusions by Commissioner of Income Tax (Appeals)
- ❖ Conclusions by Honourable Tribunal
- ❖ Analysis of order of Honourable High Court.
- ❖ Analysis of arguments at Honourable Supreme Court and Judgement thereof
- ❖ Conclusion

¹M.M. Aqua Technologies Ltd. v CIT [2021] 129 taxmann.com 145 (SC)

Study of Facts:

The assessee company had obtained a loan from financial institutions for the purpose of its business operations on which interest is payable. Terms of agreement under which loan has been obtained provides that in the event of default by the assessee, 20% of the default amount may be converted into equity at the option of the lender. The agreement further provides that repayment of principle amount and interest is to be as per the revised terms and conditions stipulated by the lender at the time of default. During the AY 1996-97, the assessee is unable to discharge its interest liability on loans obtained from financial institutions. As the assessee is unable to discharge the liability, it has approached lead financial institution for a rehabilitation plan under which the assessee has issued 3,00,149 convertible debentures of Rs 100 each amounting to Rs 3 Crore (approx.) in lieu of interest payment and claimed as deduction for the AY 1996-97 as interest liability is discharged.

However, the Assessing Officer (for brevity 'AO') has rejected the claim made by the assessee by holding that issue of debentures is not as per the terms and conditions as per the loan agreement and further, issue of debentures does not tantamount to 'actual payment'. For this purpose, the AO has relied on the wording of section 43B(d) '*in accordance with the terms and conditions of the agreement governing such loan or borrowing.*' Aggrieved by the order of the AO, the assessee had filed an appeal before the Commissioner of Income Tax (Appeals) [CIT(A)].

Conclusions by CIT (A):

The CIT (A) has allowed the claim made by the assessee by making the following conclusions:

- ❖ The original conditions not only provide for conversion of 20% of loan into equity but also revision of terms and condition of repayment at the time of default.
- ❖ The issue of debentures as mutually agreed by the assessee and financial institutions was therefore in accordance with the terms and conditions of the agreement governing the loan.
- ❖ Further, in respect of 'actual payment' as required by Section 43B, the CIT(A) has concluded that the debenture is a valuable security and can be freely negotiable and openly quoted in the stock market.
- ❖ It is not correct to say that a debenture is a piece of paper and issue of debentures against the interest is deferment of liability. Financial institutions have accepted the issue of debentures in effective discharge of interest liability which is no longer payable.
- ❖ Issue of debentures against the interest liability would be tantamount to payment of interest and such interest has been paid during the year.

Conclusions by Honorable Income Tax Appellate Tribunal (ITAT):

The order of the CIT(A) has been upheld by the Honorable ITAT² by making following observations:

- ❖ Section 43B has been inserted in order to curb the mischief of non-payment of amount by the assessee and taking the amount as deduction by following the mercantile system of accounting.
- ❖ In order to qualify the payment as 'actually paid', such liability need not to be discharged in cash, cheque or draft as provided in second proviso to Section 43B which is with reference to payment of provident fund, superannuation fund, gratuity etc.
- ❖ The debentures when subsequently redeemed during the AY 2001-02, the appellant has not claimed any deduction for the same. The interest amount which is allowed in the appellant case is reflected in the assessment of financial institution as business income thereby by nobody is put to any loss.
- ❖ Invoking of Section 43B on imaginary ground that there is no actual payment of interest would wholly be misplaced and would amount to a strained interpretation.

Given the above, the ITAT had upheld the order passed by the CIT(A) and provided relief to the assessee. The point here is to be noted is that the order of the CIT(A) and order of ITAT has come out before the insertion of Explanation 3C to 43B.

Conclusions by Honorable High Court:

Not satisfying with the order of Honorable Tribunal, revenue has filed an appeal before the High Court. The High Court has ruled³ in favour of the revenue by making the following observations:

- ❖ A new Explanation 3C has been inserted to section 43B with retrospective effect from 01st April 1989. After the insertion of explanation, conversion of interest into loan shall not be considered as 'actual payment'.
- ❖ As the explanation has retrospective applicability, the case of the appellant is squarely covered under Explanation 3C and hence, such conversion of interest into loan is not deductible under Section 43B.

However, the appellant has filed a review petition before the High Court for the reason that the Honorable High Court is erred in two aspects:

- ❖ One, the court has failed to attach due importance to the binding dicta in the case of Standard Chartered Bank⁴. The assessee has submitted that debentures are securities, and they are freely tradable.

²[2005] 143 TAXMAN 43 (DELHI) (MAG.)

³[2015] 60 taxmann.com 237 (Delhi)

⁴[2006] 6 SCC 94

- ❖ Two, the judgment inasmuch as it proceeded to answer a question different from what was originally framed. The court has answered the following question of laws ‘Whether the funding of the interest amount by way of a term loan amounts to actual payment as contemplated by Section 43- B of the Income-tax Act, 1961?’
- ❖ However, the question of law framed was ‘Whether the funding of the interest amount by way of a term ‘debenture’ amounts to actual payment as contemplated by Section 43- B of the Income-tax Act, 1961?’

In respect of these two arguments, High Court⁵ has held that any adjustment other than actual payment does not qualify for deduction under Section 43B. Thus, though debentures are securities and are actionable claim the essential fact is that they are instruments of debt, by the company acknowledging its indebtedness to pay the amount specified. The court however raised a question, that does this amount to ‘payment’ under section 43B? The court stated that it is of opinion that there is no question of any error in the judgment under review. Further, the Court stated that the above conversion of interest into debentures would have treated as actual payment but for the retrospective application of Explanation.

Analysis of arguments at Honorable Supreme Court and the Judgement thereof:

Finally, the matter has reached the Hon’ble Supreme Court to decide whether the issue of debentures in lieu of interest liability would be tantamount to actual payment as specified under Section 43B. Let us discuss the arguments made by the appellant and the revenue at Supreme Court and the verdict thereof

⁵[2016] 72 taxmann.com 171 (Delhi)

Core arguments of Appellant	Core arguments of Revenue
<ul style="list-style-type: none"> ❖ The High Court has firstly erred in answering the question of law framed. ❖ Debentures that were issued were not towards any future payment of liability but towards actual payment of interest that was due to financial institutions. ❖ The amendment to Section 43B by way of Explanation 3C with retrospective effect would have no application in the facts of this case as interest is not converted into any loan or borrowing. ❖ Debentures are actionable claims and can be sold in the market as such. ❖ Fiscal and tax statutes have to be strictly construed and that since the word "debenture" is not specified in Explanation 3C, it cannot be read into it 	<ul style="list-style-type: none"> ❖ Section 43B makes a departure from other sections of the ITA as indicated by its <i>non-obstante clause</i>. ❖ The Section was introduced so that no deductions could be claimed based on a mercantile system of accounting as actual payment would have to be made. ❖ It is being clear that a debenture is nothing but a loan, interest had, in fact, been converted into a loan on the facts of this case and squarely attracted the latter part of Explanation 3C. ❖ In this regard, the revenue has relied on National Rayon Corpn. Ltd ⁶ in which court has held that debentures are to be treated as present liability and to be shown in the company's balance as liability. ❖ The revenue has relied upon the judgement in the case of Gujarat Cypromet Ltd ⁷ in which the Honorable Apex Court has held that adjustment of interest liability by obtaining another loan is covered within the provisions of Section 43B and deserves to be disallowed.

⁶[1997] 7 SCC 56

⁷(2020) 15 SCC 460

Judgement of Honorable Supreme Court:

The Honorable Supreme Court has provided a detailed discussion of case and given its judgement as follows:

- ❖ The object of Section 43B, as originally enacted, is to allow certain deductions only on actual payment. A mercantile system of accounting cannot be looked at when a deduction is claimed under this section, making it clear that incurring of liability cannot allow for a deduction, but only 'actual payment', as contrasted with incurring of a liability, can allow for a deduction.
- ❖ Interestingly, the 'sum payable' referred to in Section 43B(d), with which the court is concerned with, does not refer to the mode of payment, unlike proviso 2 to the said section, which was omitted by the Finance Act, 2003 w.e.f. 1st April 2004, which stated that payment, in respect of provident fund, gratuity, superannuation fund, shall be made in cash, cheque or draft etc.
- ❖ As per a rehabilitation plan agreed to between the lender and borrower, debentures were accepted by the financial institution in discharge of the debt on account of outstanding interest. Further, such issue of debentures has been reflected as business income in the books of account of financial institution for the year under consideration. This being, the fact-situation in the present case, it is clear that interest was 'actually paid' by means of issuance of debentures, which extinguished the liability to pay interest.
- ❖ Explanation 3C which was introduced only made it clear that interest remained unpaid and has been converted into a loan shall not be deemed to have been actually paid. The Central Board of Direct Taxes (for brevity 'CBDT') Circular explaining the insertion of Explanation 3C states that the purpose of amendment is to curb the misuse of Section 43B by not actually paying interest but converting such interest into a fresh loan.
- ❖ On the facts found in the present case, the issue of debentures by the assessee was, under a rehabilitation plan, to extinguish the liability of interest altogether. No misuse of the provision of Section 43B was found as a matter of fact by either the CIT or the ITAT. Explanation 3C, which was meant to plug a loophole, cannot therefore be brought to the aid of Revenue on the facts of this case.
- ❖ The Supreme Court has pointed that if there is any ambiguity in the retrospectively added Explanation 3C, three well established canons of interpretation come to the rescue of the assessee in this case:
 - First, since Explanation 3C has been inserted through Finance Act, 2006 with the object of plugging a loophole - misuse of section 43B by not actually paying the interest but converting the same into a fresh loan. Hence, *bona fide* transactions of actual payments are not meant to be affected. For this purpose, the court has relied upon its judgement in the case of K.P. Varghese⁸.

⁸[1981] 4 SCC 173

- Second, a retrospective provision in a tax act which is '*for the removal of doubts*' cannot be presumed to be retrospective, even where such language is used, if it alters or changes the law as it earlier stood. This being the case, Explanation 3C is clarificatory - it explains Section 43B(d) as it originally stood and does not purport to add a new condition retrospectively, as has wrongly been held by the High Court.
 - Third, any ambiguity in the language of Explanation 3C shall be resolved in favour of the assessee. For this purpose, the Supreme Court has relied on its judgement in the case of Vodafone International Holdings BV⁹.
- ❖ The Supreme Court has ruled out the cases relied on by the revenue as follows:
- In respect of first case i.e., National Rayon Corpn. Ltd. v. CIT (supra), the Court has held that the question decided in that case is far removed from the question to be answered in the facts of present case.
 - The question in present case does not depend upon what a debenture under law and/or whether it can be convertible or non-convertible or payable immediately or in the future. The question in the present case is only '*whether interest can be said to have been actually paid by the mode of issuing debentures.*' Hence, the court has ruled out the case relied upon by the revenue.
 - In respect of second case i.e., CIT v. Gujarat Cypromet Ltd (supra), the court has held that Explanation 3C was attracted in that case as outstanding interest had not actually been paid, but a new credit entry of loan now appeared. This is far removed from the facts of the present case, which were not adverted to at all in this judgment. Accordingly, the Supreme Court has set aside the order passed by the Hon'ble High Court and restored the order of ITAT.

Conclusion:

After the above detailed analysis of Section 43B read with Explanation 3C which was inserted through the Finance Act, 2006 with retrospective effective from 1st April 1989, the Supreme Court has held that issue of debentures against the outstanding interest liability as final discharge of liability would be treated as actual payment of interest and such amount need not to be disallowed under Section 43B.

The Supreme Court has followed the three rules of interpretation in order to remove ambiguity under section 43B. Last year, the same Supreme Court in the case of Gujarat Cypromet Ltd (supra) has held that as Explanation 3C is inserted with retrospective effect, setting off of interest with fresh loan obtained would not be treated actual payment of interest. However, the facts of the present case are entirely different as debentures are issued as final discharge of interest obligation and such issue cannot be considered as conversion into a fresh loan. The Hon'ble Supreme Court through its judgement in this case has laid down the following principles of interpretation that intention behind the entering into a transaction has more value than the literal interpretation of the statute. Further, the Court held that an

⁹[2012] 6 SCC 613

amendment which provides that 'for the removal of doubts' cannot be presumed to be retrospective, even though the provision provides for retrospective effective, in order to alter the law which was not there before. Finally, the Court stated that tax laws have to be interpreted more strictly and if there is any ambiguity while interpretation, the benefit of doubt should be in favour of the tax payer.

On a more technical side, the question remained unanswered is whether a retrospective amendment can be applied when such amendment is not present in the statute at the time of completion of assessment by the AO and subsequently, the law has been amended retrospectively when such matter is pending at appellate forum. This question is expressly dealt by the Karnataka High Court in the case of Vikram Reddy¹⁰ where in the High Court has mentioned that there was a lacuna in law which has been addressed by Finance Act, 2012 by introducing a new clause with effective from 01st April 1999. The Court has opined that as the assessment is completed before the said amendment, the amendment may not have an effect on the assessment. The court has expressed its opinion, when a new clause has been inserted in a particular section which was not there under the existing provisions. However, the same proposition may not hold good when a new explanation is inserted with retrospective effect in order to explain the existing provisions.

If the view of Karnataka High Court is applied into Section 43B read with Explanation 3C, in the present case, as the assessment for the AY 1996-97 is completed much before the insertion of Explanation 3C through the Finance Act, 2006, the question of applying explanation may not arise. However, for the similar facts to the present case, the Supreme Court in the case of Gujarat Cypromet Ltd (supra) has held that Explanation 3C is squarely applicable to the appellant in that case as explanation has retrospective applicability. Which means that even though the assessment is concluded and same is pending at appellate forum, a retrospective amendment being an expla

¹⁰I.T.A. NO.291 OF 2013

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