

IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL NO.776 OF 2011

The Director of Income Tax
International Taxation-II,
Scindia House, Ballard Estate,
N.M.Road, Mumbai-400038. ...Appellant.

Vs.

M/s. Besix Kier Dabhol SA,
F/19,Sai Siddhi,
Opp. Gulmarg Society,Charai, Chembur Naka,
Chembur, Mumbai 400071,
Pan AAACB6191J. ...Respondent.

Mr.Suresh Kumar for the Appellant.
Mr. P. Pardiwalla, Sr.Counsel for the Respondent.

**CORAM : S.J.VAZIFDAR &
M.S. SANKLECHA, JJ.**

DATE : 30th August, 2012

P.C.:

This appeal by the revenue under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as "the Act") challenges an order dated 10/11/2010 of the Income Tax Appellate Tribunal (hereinafter referred to as the "Tribunal") in ITA No.4249/Mum./2007 relating to Assessment year 2002-03.

2) Being aggrieved, the revenue has formulated the following questions of law for the consideration by this Court.

i) Whether on the facts and circumstances of the case and in law the Tribunal was right in holding that in the absence of any specific thin capitalization rules in India, the Assessing officer cannot disallow the interest payment on debt capital after having observed the abnormal thin capitalization ratio of 248:1?

ii) Whether on the facts and circumstances of the case and in law the Tribunal was right in holding that the deduction of interest claimed was u/s. 36(1)(iii) and not u/s.37 of the Act as held by the CIT(A)?

iii) Whether on the facts and circumstances of the case and in law the Tribunal was right in holding that the profit of the assessee company liable to be taxed in India are its entire profits taxable in India and all its expenses are deductible in ascertainment of its taxable income ignoring the fact that the interest payment was made to the

share holders of the assessee with the debt equity capital ratio of 248:1 and which can be considered as payment to self covered by the provisions of Article 7(3)(b) of the DTAA and, therefore, not allowable expenditure?

- 3) The appeal is admitted on Question (ii) and (iii).

Re Question (i) :

4) The respondent-assessee is a company incorporated under the laws of Belgium. The sole business of the respondent-assessee is to carry out the project of construction of fuel jetty near Dabhol in India. The respondent-assessee had fully paid capital of 25.00 lacs (Belgium Francs) divided into 2500 shares of 1000 Belgium Francs each. This equity capital was divided in the ratio of 60:40 between the two joint venture partners N V Besix SA, Belgium and Kier International (Investment) Limited of U.K. The respondent assessee also borrowed from its shareholders in the same ratio as the equity share holding amount of Rs.57.09 crores from N.A. Basix SA and Rs.37.01 crores from Kier International Investment Limited. In the circumstances, the respondent had equity capital of Rs. 38.00 lacs and debt capital of Rs.9410 lacs. Thus, debt equity ratio worked out is to

248:1.

5) The respondent assessee paid interest of Rs. 5.73 crores on the aforesaid borrowing of Rs.57.09 crores and Rs.37.01 crores from NV Basix SA and Kier International (Investments) Limited respectively. However, the Assessing Officer disallowed the payment of interest in view of the Reserve Bank of India's approval letter dated 3/11/1998 granting approval to the assessee to do business in India. The approval letter dated 03/11/1998 specifically provided that India Branch Office will not borrow or lend from/to any person in India without specific permission of the Reserve bank of India. The Assessing officer further observed that in view of India Belgium Double Taxation Avoidance Agreement interest on monies paid by the Head Office to the branches was not allowable as a deduction.

6) In appeal, the Commissioner of Income Tax (Appeals) by an order dated 29/3/2007 upheld the order of the Assessing officer and disallowed the deduction on account of interest of Rs.5.73 crores paid to Joint Venture Partners. The Commissioner of Income Tax (Appeals) held that Article 7(3)(b) of the Double Taxation Avoidance Agreement forbids allowance of any interest paid to the head office by permanent

establishment in India as a deduction. Further, the payment of interest also directly violates the conditions imposed by RBI in its letter dated 3/11/1998. Therefore, the order of the Assessing Officer was upheld.

7) However, the Tribunal allowed the respondent-assessee's appeal. During the course of the proceedings before the Tribunal the revenue contended that the borrowings on which the interest has been claimed as a deduction are in fact capital of the assessee and brought only under the nomenclature of loan for tax consideration. It was the case of the appellant-revenue before the Tribunal that debt capital is required to be re-characterized as equity capital. However, the Tribunal held that in India as the law stands there were no rules with regard to thin capitalization so as to consider debt as an equity. It is only in the proposed Direct Tax Code Bill of 2010 that as a part of the General Anti Avoidance Rules it is proposed to introduce a provision by which a arrangement may be declared as an impermissible avoidance arrangement and may be determined by recharacterising any equity into debt or vice versa.

8) We find no fault with the above observations of the Tribunal. There were at the relevant time and even today no thin

capitalization rules in force. Consequently, the interest payment on debt capital cannot be disallowed. In view of the above, the question (i) raises no substantial question of law and is therefore, dismissed.

9) Appeal is admitted with regard to Question (ii) and (iii).

(M.S. SANKLECHA, J.)

(S. J. VAZIFDAR, J.)

