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**IN THE HIGH COURT OF DELHI AT NEW DELHI**

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**ITA 780/2014**

COMMISSIONER OF INCOME TAX –V ..... Appellant  
Through: Mr. N. P. Sahni, Senior Standing  
Counsel with Mr. Nitin Gulati, Advocate.

versus

RATHI GRAPHICS TECHNOLOGIES LTD. .... Respondent  
Through: Mr. Satyen Sethi, Advocate.

**AND**

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**ITA 785/2014**

COMMISSIONER OF INCOME TAX –V ..... Appellant  
Through: Mr. N. P. Sahni, Senior Standing  
Counsel with Mr. Nitin Gulati, Advocate.

versus

RATHI GRAPHICS TECHNOLOGIES LTD. .... Respondent  
Through: Mr. Satyen Sethi, Advocate.

**CORAM:**

**HON'BLE DR. JUSTICE S. MURALIDHAR**

**HON'BLE MR. JUSTICE VIBHU BAKHRU**

**ORDER**

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**06.08.2015**

1. These appeals under Section 260A of the Income Tax Act, 1961 ('Act')  
by the Revenue is directed against an order dated 17<sup>th</sup> January 2014 passed

by the Income Tax Appellate Tribunal ('ITAT') in ITA No.2894/Del/2011 and Cross Objection No. 60/Del/2013 relevant to the Assessment Year ('AY') 2002-03.

2. In respect of the Respondent/Assessee, a rehabilitation scheme was sanctioned by the Board for Industrial and Financial Reconstruction ('BIFR') on 1<sup>st</sup> November 2002. The scheme that was sanctioned was in fact prepared by the Industrial Development Bank of India ('IDBI'), one of the major lenders of the Respondent. On the loans borrowed by the Assessee from IDBI, there was outstanding interest as on 31<sup>st</sup> March 2001. It was decided in a series of meetings that the IDBI could be allotted 14,30,000 equity shares of Rs.10 each valued at Rs.1.43 crores and the interest to the extent would be taken as having been paid as on 31<sup>st</sup> March 2002.

3. For the previous year ended on 31<sup>st</sup> March 2002, relevant to AY 2002-03, the Assessee filed a return on 31<sup>st</sup> October 2002 declaring a loss of Rs.2,04,58,365. In computing the returned loss, the unpaid interest to the IDBI of Rs.3,45,09,854 was added back to the net loss as per the Profit & Loss Account. Thereafter, deduction of interest paid to IDBI to the extent of Rs.1.43 crores was claimed. The basis for this claim was the allotment of shares in the above manner to the IDBI. In the audited accounts for the year ended 31<sup>st</sup> March 2002, the following note was appended under the notes on accounts:

“IDBI has approved a negotiated settlement for the company. As per the terms of the rehabilitation based on the settlement, the company has issued 14,30,000 equity shares of Rs.10/- each to IDBI towards 30% simple interest due as on 31/03/2001. The interest outstanding as at 31/03/2002

has been reduced to that extent. The other relief of the negotiated settlement would be accounted-for on the approval of rehabilitation scheme by the BIFR.”

4. Further in the computation of income for AY 2002-03, which was placed before the Assessing Officer (‘AO’), the Assessee appended the following note in para 11:

“During the year, IDBI approved a negotiated settlement, where-under IDBI against the outstanding interest due on 31.03.2001 accepted 14,30,000 equity shares of Rs.10/- each valued at 1,43,00,000/-. The above shares were accepted towards 30% simple interest due as on 31.03.2001. Pursuant to above, outstanding interest as at 31.03.2001 has been reduced to the interest of Rs.1,43,00,000/-. The above payment of interest in kind had been added back by the Assessee in earlier years. Since interest to the extent of Rs.1,43,00,000/- has been paid in the relevant previous years, therefore, the same has been claimed deduction within the meaning of Section 43B of the Act. Various Tribunals have held the words actual payment in Section 43B are to be liberally construed and would cover every discharge of liability. The accrued interest for the 01.04.2001 to 31.03.2002 has been added back in the computation of income [see note 2 (iii) (a)].”

5. It may be added here that the actual date of allotment of 14,30,000 shares by the Respondent Assessee to the IDBI was 30<sup>th</sup> March 2002. The issued, subscribed, called up and paid up capital was increased correspondingly.

6. During the course of the original assessment proceedings, the AO by an order dated 4<sup>th</sup> November 2004 raised a specific query regarding the shares issued to the IDBI. By a letter dated 22<sup>nd</sup> November 2004, the Assessee

explained, *inter alia*, that pursuant to the settlement reached with the IDBI which was confirmed by IDBI by letter dated 22<sup>nd</sup> January 2002, the shares as aforementioned were allotted. It was urged that the said allotment of shares should be taken to be against the interest amount 'actually paid' within the meaning of Section 43B of the Act. It was explained that by order dated 1<sup>st</sup> November 2002 the BIFR was only approving the scheme already prepared by IDBI and acted upon by the Assessee and IDBI.

7. It appears that after the assessment was completed under Section 143 (3) of the Act on 30<sup>th</sup> November 2004, the case of the Respondent was re-opened under Section 147 of the Act. This admittedly was done within four years thereafter. The reasons for the reopening, as stated by the AO, was that it was noticed that the Assessee had claimed and was allowed a deduction of Rs.1.43 crores towards the allotment of shares to the IDBI on conversion of 30% of the simple interest in equity share capital. It was noted that since the rehabilitation scheme was sanctioned by the BIFR on 1<sup>st</sup> November 2002, the said deduction was not allowable during the AY 2002-03.

8. The AO did not accept the contention of the Assessee that the IDBI had already approved the proposal for conversion of a part of the interest into shares by a letter dated 22<sup>nd</sup> January 2002. The AO was of the view that in terms of Section 43B of the Act, deduction is allowable on actual payment basis and allotment of equity shares in lieu of interest liability cannot be construed as actually paid as required under Section 43 B of the Act. Further the Form No.2 filed by the Assessee showed the date of allotment as

30<sup>th</sup> March 2002 which was “not clearly legible”. Since the return of allotment in Form No.2 was filed with the Registrar of Companies (‘ROC’) only on 29<sup>th</sup> April 2002, and was lying with the Assessee till that date, that by itself was not sufficient to prove that the shares were in fact allotted to IDBI on 30<sup>th</sup> March 2002. Consequently, the deduction of Rs.1.43 crores was disallowed and added back to the income of the Assessee.

9. In the appeal filed by the Assessee, the CIT (Appeals) [‘CIT (A)’] by order dated 25<sup>th</sup> April 2011 held that the re-opening of the case under Section 147 of the Act was valid. However, on merits the CIT (A) deleted the addition. Aggrieved by the aforementioned order, the Revenue went in appeal before the ITAT and the Assessee filed its cross objections.

10. In the impugned order dated 17<sup>th</sup> January 2014, the ITAT noted that the only reason for the re-opening was that the rehabilitation scheme was sanctioned by the BIFR on 1<sup>st</sup> November 2002 and, therefore, the deduction was not allowable during AY 2002-03. After going through the facts and examining the records, the ITAT noted that in the original assessment proceedings itself the AO had raised a query which had been explained satisfactorily by the Assessee and accepted by the AO. Therefore, “the present case is not a change of statement of income and rather it is a case of change of opinion.”

11. Mr. N.P. Sahni, learned Senior Standing counsel appearing for the Revenue, urged that this was not a case where the AO had examined an issue and recorded satisfaction in the original assessment order. He referred to Explanation 1 to Section 147 which states that “Production before the AO

of account books or other evidence from which material evidence could with due diligence have been discovered by the AO will not necessarily amount to disclosure.” He further urged that the mere conversion of a portion of the outstanding interest into share will not amount to actual payment of interest and therefore qualify for deduction under Section 43 B of the Act. He referred to Explanation 3C to Section 43B which declares that where a deduction in respect of any amount being the interest payable has been converted into a loan or borrowing it shall “not to be deemed to have been actually paid.” He accordingly submitted that the AO was justified in seeking to reopen the assessment. Mr. Sahni further submitted that if in fact the conversion into shares took place only pursuant to the sanctioning of the scheme by the BIFR on 1<sup>st</sup> November 2002, the deduction could in any event not have been claimed in AY 2002-03.

12. Mr. Satyen Sethi, learned counsel appearing for the Assessee, has produced before the Court the computation of income which was placed before the AO. It contains the explanatory note extracted hereinbefore. He submitted that the full facts of the case were already available with the AO in the original assessment proceedings. This was a case of mere change of opinion particularly since a specific query has been raised by the AO in regard to conversion of a party of interest into shares. The Assessee’s answer to the query was accepted by the AO and the assessment was finalized accordingly.

13. Mr. Sethi further pointed out that Explanation 3C to Section 43 B of the Act deals with the situation of conversion of interest into a loan or

borrowing. Explanation 3C to Section 43B of the Act was introduced retrospectively with effect from 1<sup>st</sup> April 1989. There is no provision, much less with retrospective effect, by which conversion of interest into shares has been described as not amounting to actual payment for the purposes of Section 43B of the Act.

14. Having heard the above submissions, the Court is satisfied that this was indeed a case of mere change of opinion by the AO. As noticed hereinbefore, a specific query was raised by the AO in the original assessment proceedings itself as regards the conversion of a portion of the interest into shares. The said query, as found in the order dated 4<sup>th</sup> November 2004, reads as under:

“In the return, a deduction of Rs.1.43 Cr is claimed – share capital issued to IDBI. When the money is with you, how and on what basis the deduction has been claimed. -Give a detailed note in regard to the claim of deduction of Rs.1.43 Cr in the computation of income. How the deduction has been claimed under section 43B of the Act.”

15. The Respondent Assessee replied to the above query on 29<sup>th</sup> November 2004. In its reply the Respondent explained that the allotment of shares was pursuant to the settlement arrived at with the IDBI and the IDBI had agreed to the conversion of a portion of the interest into shares by its letter dated 22<sup>nd</sup> January 2002. It was also explained to the AO that the allotment of shares took place in fact on 30<sup>th</sup> March 2002. The mere fact that the return of allotment was filed with the ROC only on 29<sup>th</sup> April 2002 or that the BIFR may have

sanctioned the scheme only on 1st November 2002, would not change the actual date on which the shares stood allotted i.e. 30<sup>th</sup> March 2002.

16. When pursuant to a settlement the creditor agrees to convert a portion of interest into shares, it must be treated as an extinguishment of liability to pay interest to that extent. In essence there will be no further outstanding interest to that extent. Consequently, the situation where an interest payable on a loan is converted into shares in the name of the lender/creditor is different from the situation envisaged in Explanation 3C to Section 43B of the Act viz., conversion of interest into “a loan or borrowing”. In the latter instance, the liability continues, although in a different form. However, where the interest or a part thereof is converted into equity shares, the said interest amount for which the conversion is taking place is no longer a liability.

17. The Court is of the view that the plea of the Assessee, which was accepted by the CIT (A) and the ITAT, that the said conversion of a portion of interest into shares should be taken to be “actual payment” within the meaning of Section 43B of the Act, merits acceptance. In any event, on the facts of the case discussed above, there was no justification in seeking to reopen the assessment under Section 147 of the Act on a mere change of opinion.

18. In that view of the matter, the Court finds no legal infirmity in the impugned order of the ITAT. The Court declines to frame questions of law as urged by the Revenue.



19. The appeals are dismissed.

**S. MURALIDHAR, J**

**VIBHU BAKHRU, J**

**AUGUST 06, 2015/dn**

