आयकर अपीलीय अधिकरण, हैदराबाद पीठ

IN THE INCOME TAX APPELLATE TRIBUNAL
Hyderabad ' A ' Bench, Hyderabad

Before Shri R.K. Panda, Accountant Member
AND
Shri Laliet Kumar, Judicial Member

ITA No.347/Hyd/2019		
Assessment Year: 2014-15		
M/s. Fairfield Developments Limited, Hyderabad. PAN : AABCF3158N	Vs.	Dy. Commissioner of Income Tax, International Taxation – 1 Hyderabad.
(Appellant)		(Respondent)
ITA 488/Hyd/2019		
Assessment Year 2014-15		
Dy. Commissioner of Income Tax, International Taxation – 1, Hyderabad.	Vs.	M/s. Fairfield Developments Limited, Hyderabad. PAN : AABCF3158N
(Appellant)		(Respondent)
Assessee by:	Shri Akshay Surana & Siddharth Surana, C.A	
Revenue by:	Shri K.P.R.R. Murthy	
Date of hearing:	27.03.2023	
Date of pronouncement:	25.04.2023	

O R D E R

Per Laliet Kumar, J.M.

These two appeals filed by the assessee and the Revenue, respectively, are directed against the order of Commissioner of Income Tax (Appeals) – 10, Hyderabad dated 16.01.2019 for the assessment year 2014-15.

2. The Assessee has raised the following grounds :

"1. The order of CIT(A) is erroneous and contrary to the facts of the case and law on point.

2. The ld.CIT(A) has erred in sustaining the action of TPO / Assessing Officer in proposing the interest rate on fully compulsory convertible debentures at LIBOR+200 basis points ignoring that the fully compulsory convertible debentures were denominated in INR and interest for the same is appropriately benchmarked to SBI Prime lending rate.

3. The ld.CIT(A) has erred in sustaining the action of TPO / Assessing Officer by overlooking the same issue decided in respect of the same instruments in favour of the appellant.

4. The ld.CIT(A) has erred in sustaining the action of the TPO / Assessing Officer in application of 11(7) of the India – Cyprus DTAA.

5. The ld.CIT(A) has erred in sustaining the action of the TPO / Assessing Officer in the application of second proviso to section 92(4).

2.1 Thereafter, assessee has raised the additional grounds which read as under:

"1. Without prejudice to the other grounds submitted in the original submission, we would like to rely on the provisions of Article 3 of the Double taxation avoidance agreement between India and Cyprus in respect of the interest paid / payable to the associated enterprise."

2. Without prejudice to the other grounds, the Assessing Officer erred in recharacterizing bonafide interest payment transaction, by splitting a transaction of single nature interest payment into two tranches i.e. interest and other income other than interest income, on surmise basis."

3. Without prejudice to the other grounds, the Assessing Officer further erred in not considering the fact that in case of any other income, the appellant shall be taxable only in the country of residence as per Article 22(1) of the India – Cyprus Double Taxation avoidance agreement.

4. Without prejudice to the other grounds, the Assessing Officer further erred in applying the provisions of Article 11 of Double taxation of avoidance agreement between India and Cyprus.

2.2. The only effective ground raised by the Revenue reads as under :

"The ld.CIT(A) has erred in law in holding that word "Tax" does not include 'Surcharge' and 'Education Cess' for the purposes of the Double Taxation Avoidance Agreement with Cyprus."

3. Facts of the case, in brief, are that assessee is a foreign company incorporated in Cyprus. It is engaged in the business of real estate and development. The assessee e-filed its original return of income for A.Y. 2014-15 on 30.09.2014 declaring income of Rs.16,72,31,170/- and subsequently, a revised return was filed on 13.03.2015 declaring a refund of Rs.5,47,74,900/-. Subsequently, the case was selected for scrutiny and accordingly, notice u/s 142(1) of the Income Tax Act, 1961 dated 07/ 06/ 2016 was issued and duly served. Thereafter, notices u/s 142(1) of the Act dated 24/ 06/ 2017 and 01/ 12/2017 were also duly issued and served. Thereafter, the case was referred to the TPO for determination of Arm's Length Price (ALP) and the TPO on examination of international transactions rejected the Transfer Pricing analysis but did not propose for any adjustment of income as the same has been proposed in case of WRPL on the same transaction to benchmark the interest paid/ payable on FCCD's denominated in INR at LIBOR plus 200 basis points. A copy of TPO order of WRL was forwarded to the appellant and notice dt.12.12.2017 was issued by the

Assessing Officer asking to show cause as to why excess interest income of Rs. 13,98,41,656/ - be not taxed at 40% plus surcharge relying on article 11(7) of India - Cyprus DTAA. The assessee contended since the FCCD's are in the nature of equity instruments and are denominated in INR and interest on the same is payable in INR, the same has to be benchmarked at the currency specific interest rate benchmark of SBI PLR. However, the Assessing Officer had adopted LIBOR plus 200 basis points as more appropriate to determine the arm's length price, rejecting the SBI PLR plus 300 basis points adopted by the appellant. Finally, the Assessing Officer had taxed the excess interest of Rs. 13,98,41,656/ - at 40% and ALP of Rs. 2,73,89,512/ -is taxed at DTAA rate of 10% and passed assessment order under sec.143(3)r.w.s 144C of the Act.

4. Feeling aggrieved with the final assessment order, assessee carried the matter before ld.CIT(A), who granted partial relief to the assessee.

5. Feeling aggrieved with the order of ld.CIT(A), both the assessee and Revenue are now in appeal before us.

6. Admission of Additional grounds :

We have heard the rival submissions and perused the material on record. Suffice to say, Hon'ble Apex Court's landmark decision in National Thermal Power Co. Ltd., Vs., CIT [229 ITR 383] (SC); as considered in Tribunal's Special Bench's decision All Cargo

Global Logistics Ltd., Vs. DCIT (2012) [137 ITD 217](SB) (Mumbai), holds that the Tribunal can very well entertain a new ground going to root of the matter so as to determine correct tax liability of a taxpayer provided all the relevant facts are already on record. Respectfully, following the decisions cited supra, we accept that the assessee's petition seeking to raise additional grounds. Further, as the additional grounds raised by the assessee are legal in nature and directly emanate from the order contested, the same are admitted.

6.1. First, we will deal with the grounds raised by the assessee.

6.2. Ground No.1 is general in nature and requires no adjudication.

6.3. With respect to ground No.2, the Bench has already decided the issue against the assessee in the case of M/s. Watemarke Residency Limited, Hyderabad which is a subsidiary company of M/s. Fairfield Development Limited, Hyderabad (assessee company by holding as under :

> *"19. We have heard the rival submissions and perused the material on record. We have also examined the remaining decisions. Before we deal with the issue, it is necessary to understand the nature of the instrument and the competing law in this regard. As per Para 7 (supra) of TPO's order reproduced hereinabove, the assessee company required funds for its business operations in India and for that purpose, the assessee had issued unsecured FCCDs to its holding company, the assessee had mentioned the said transactions in his T.P. Study for the assessment year 2013-14 and for the assessment year 2014-15.*

A.E.	***Nature of transaction***	***Amount (Rs.)***
Fairfield Developments Ltd, Cyprus	*Interest @ 15.75% on 8811 Fully Compulsorily Convertible Debentures of Rs.1,00,000/- each for entire year.*	*133559610*
Fairfield Developments Ltd, Cyprus	*Interest @ 17.75% on 1335 Fully Compulsorily Convertible Debentures*	*149385800*

International transactions during the assessment year 2014-15 :

A.E.	*Nature of transaction*	*Amount (Rs.)*
Fairfield Developments Ltd, Cyprus	*Interest on 8,811 FCCDs*	*13,87,73,250*
Fairfield Developments Ltd, Cyprus	*Interest on 10,415 FCCDs*	*2,84,57,918*
Fairfield Developments Ltd, Cyprus	*Issue of FCCDs*	*2,69,00,000*

20. The assessee company had issued FCCDs valued at Rs.2.69 crores to M/s.Fairfield Development Limited. The terms and conditions of issuance of debentures as per debenture certificate vide Para 8 of the TPO order was reproduced below :

"8. ……

***Allotment** :- The debenture are allotted on*

***Conversion Date** :- 120 (one hundred twenty) months from the date of allotment.*

***Interest Rate** :- (Benchmark + Spread) % per annum, where Benchmark means prime lending rate (PLR) of State Bank of India prevailing on the date of the meeting of the Board of Directors of the company at which the FCD is issued; and Spread means 3% per annum.*

***Interest Payment Frequency** :- Annually on 31st March of Each Year*

Conversion on Conversion Date *:- Each Debenture would be compulsorily fully convertible into Equity Shares at a price per Equity Share that is mutually agreed upon by the company and the FCD Holder on the Conversion Date, subject to the company meeting with the minimum capitalization criteria prescribed under the applicable Law.*

Conversion Option before Conversion Date *:- At any time during or before the conversion date, each FCD may at the option and sole discretion of its holder be convertible into Equity Share at a price per Equity share that is mutually agreed upon by the Company and the FCD Holder on the Conversion Date, subject to the Company meeting with the minimum capitalization criteria prescribed under the applicable law.*

Security : *- The Debentures are unsecured.*

Ranking : *- Upon conversion of FCDs into equity shares, the same shall rank pari passu with the existing equity shares of the company."*

21. The notable points are that

1) *The debentures were issued for a period of 120 months (10 years),*
2) *The interest rate payable was PLR of SBI Plus 300 basic points.*
3) *Debentures would be compulsorily converted into equity at a price that is mutually agreed.*
4) *The A.E. of the assessee has an option to convert FCCD into equity at a price mutually agreed before the stipulated conversion date.*
5) *The debentures are unsecured.*
6) *The debentures after upon conversion of FCCD into equity, would be equal to the shares of the company.*
7) *There is no clarity as applicable foreign currency rate i.e whether rate prevalent at the time of conversion would be taken into account or the rate the time of issuance of FCCD.*

22. The uncontroverted finding recorded by the TPO was that as per the RBI Guidelines the CCDs are in the nature of loans. The ld.AR for the assessee has not brought to our notice any guidelines / regulation issued by the RBI treating the CCD / FCCD as equity. On the contrary, the assessee has mentioned the FCCD as debt and thereafter has selected the comparable company which had received loan on the basis of debt instrument.

23. Undoubtedly, FCCDs are debt when these were issued, and it would continue to be debt till such time it is compulsorily converted into equity in terms of issuance. Further, after FCCD would be converted into equity then the holder of the equity shall have a right to receive dividend from the company, also have a right to vote in the affairs of company and also have other incidental rights as available under the Companies Act, 2013. As per our understanding, FCCD, do not have the above noted attributes of equity. Moreover, claim of the assessee, treatment of FCCD treat FCCD as equity is unsustainable for the simple reason that payment of interest on equity is not an allowable expenditure under the Income Tax Act, 1961.

24. However, if we examine terms of issuance of FCCD for A.Y. 2013-14 and 2014-15 then it is amply clear that the assessee itself had treated the FCCD as debenture and claimed payment of interest as an allowable expenditure. In the documents, the terms of debenture were mentioned as under :-

> *"Terms of Debenture are*
>
> *1. Debentures would be compulsorily converted into equity shares at the end of 120 months from the date of allotment, but may be converted at any time before the conversion date at the option and sole discretion of its holder."*

25. In the present case, the TPO had benchmarked the transaction after treating the FCCDs as debt. This finding of TPO was based on Terms of issuance of FCCD and balance-sheets/ financials of the assessee as well as of it's A.E, where both had mentioned FCCD as debt. We agree with the finding of lower authority that FCCD is a debt, as holder had a right to recover the debt and had a right to receive the interest on the debt from the payee. Further assessee during the hearing had also agreed that the FCCD are debt instrument till its conversion. Further assessee had capiatlised the interest, being prior period expenses, however it was admitted that the interest was allowable expenditure as per section 36 r/w 2(28A) of the Income Tax Act 1961. In view thereof, we find no fault in the finding returned by the TPO/ld.CIT(A).

26. Assessee before the ld.CIT(A) had stated in reply dated 15/6/2017 that FCCD are in the nature of equity instruments and are denominated in INR and interest is payable in INR. Thus the assessee had changed its stand before ld.CIT(A), which is contrary to terms of issuance of FCCD, its financials and TP study, which is not permissible. Assessee had not given any reason for claiming the FCCD as equity. In our view the assessee cannot change the nomenclature of instrument from debt to equity for the purposes of bench marking the interest paid by its to AE, which would result into shifting of profit of assessee to its AE, in low tax jurisdiction. No

prudent person like assessee having strong fundamentals and financials would pay such interest to its AE at the rate of 17-to 18% on debt instrument. As per Chart filled by assessee, no interest was actually paid upto financial year 2012-13 and only paltry sum was paid in A.Y. 2012-13 to 2015-16. The details of which filed by the assessee are as under :

Statement of FCCDs issued, Interest Cost on INR denominated FCCDs, TDS, and Interest payments made					
		Details of Interest on INR denominated FCCDs			
Financial Year	***Value of FCCDs INR received***	***Interest expenditure of INR value of FCCDs***	***TDS deducted***	***Net payable Interest***	***Payment of Interest***
2007-08	*61,91,00,000*	*3,22,03,097*	*33,99,842*	*2,88,03,255*	
	18,76,00,000				
2008-09		*12,70,55,250*	*1,34,13,858*	*11,36,41,392*	
2009-10	*1,74,00,000*	*10,17,52,231*	*1,07,42,492*	*91,10,09,739*	
	46,00,000				
	20,00,000				
2010-11	*1,29,00,000*	*13,33,87,526*	*1,40,82,388*	*11,93,05,138*	
	60,00,000				
2011-12	*30,00,000*	*13,70,92,389*	*1,44,73,529*	*12,26,18,860*	
	6,00,000				
	2,01,00,000				
	24,00,000				
	69,00,000				
	12,00,000				
2012-13	*1,44,00,000*	*14,93,85,800*	*1,56,94,472*	*13,36,91,328*	*50,00,000*
	13,00,000				
	3,92,00,000				
	18,00,000				
	77,00,000				
	18,00,000				
	6,60,00,000				
	13,00,000				
2013-14	*2,69,00,000*	*16,72,31,168*	*7,23,44,203*	*9,48,86,965*	*4,65,43,559*
2014-15		*3,74,48,500*	*1,57,37,358*	*2,17,11,142*	*25,75,000*

27. The ld.AR for the assessee has drawn our attention to the judgment of the Hon'ble Bombay High Court in the case of PCIT Vs. India Debt Management reported in (2019) 106 Taxmann.com (Bom) 55, whereby the hon'ble Bombay High Court had decided the issue in para 3 and 6 as under :

"3. Having heard learned Counsel for the parties and having perused the materials on record, we are broadly in agreement with the view of tribunal. The significant features of the assessee's case were that the assessee was mainly engaged in identifying the companies in financial distress whose products were otherwise viable and taking over or financing of such companies. The business of the assessee was thus froth with inherent risks. Its credit rating therefore was relatively low of 'BBB-'. The assessee was raising funds for such investments through issuance of debentures to its AEs. The tribunal even on comparison found that the average rate of interest of 11.30% paid by the assessee to its AEs was not excessive and was in any case lower than in the comparable instances. The tribunal rejected the transfer pricing adjustment comparing the rate of return for the assessee's US based AE. This later conclusion of the Tribunal is supported by following decisions.

4. Division Bench of Delhi High Court in case of CIT v. Cotton Naturals (I) (P.) Ltd. [2015] 55 taxmann.com 523/231 Taxman 401, had held and observed as under;

"39. The question whether the interest rate prevailing in India should be applied, for the lender was an Indian company/assessee, or the lending rate prevalent in the United States should be applied, for the borrower was a resident and an assessee of the said country, in our considered opinion, must be answered by adopting and applying a commonsensical and pragmatic reasoning. We have no hesitation in holding that the interest rate should be the market determined interest rate applicable to the currency concerned in which the loan has to be repaid. Interest rates should not be computed on the basis of interest payable on the currency or legal tender of the place or the country of residence of either party. Interest rates applicable to loans and deposits in the national currency of the borrower or the lender would vary and are dependent upon the fiscal policy of the Central bank, mandate of the Government and several other parameters. Interest rates payable on currency specific loans/deposits are significantly universal and globally applicable. ***The currency in which the loan is to be re-paid normally determines the rate of return on the money lent, i.e. the rate of interest.*** *Klaus Vogel on Double Taxation Conventions (Third Edition) under Article 11 in paragraph 115 states as under:-*

"The existing differences in the levels of interest rates do not depend on any place but rather on the currency concerned. The rate of interest on a US $ loan is the same in New York as in Frankfurt-at least within the framework of free capital markets (subject to the arbitrage). In regard to the question as to whether the level of

interest rates in the lender's State or that in the borrower's is decisive, therefore, primarily depends on the currency agreed upon (BFH BSt. B1. II 725 (1994), re. 1 AStG). A differentiation between debt-claims or debts in national currency and those in foreign currency is normally no use, because, for instance, a US $ loan advanced by a US lender is to him a debt-claim in national currency whereas to a German borrower it is a foreign currency debt (the situation being different, however, when an agreement in a third currency is involved). Moreover, a difference in interest levels frequently reflects no more than different expectations in regard to rates of exchange, rates of inflation and other aspects. Hence, the choice of one particular currency can be just as reasonable as that of another, despite different levels of interest rates. An economic criterion for one party may be that it wants, if possible, to avoid exchange risks (for example, by matching the currency of the loan with that of the funds anticipated to be available for debt service), such as taking out a US $ loan if the proceeds in US $ are expected to become available (say from exports). If an exchange risk were to prove incapable of being avoided (say, by forward rate fixing), the appropriate course would be to attribute it to the economically more powerful party. But, exactly where there is no 'special relationship', this will frequently not be possible in dealings with such party. Consequently, it will normally not be possible to review and adjust the interest rate to the extent that such rate depends on the currency involved. Moreover, it is questionable whether such an adjustment could be based on Art. 11 (6). For Art. 11(6), at least its wording, allows the authorities to 'eliminate hypothetical' the special relationships only in regard to the level of interest rates and not in regard to other circumstances, such as the choice of currency. If such other circumstances were to be included in the review, there would be doubts as to where the line should be drawn, i.e., whether an examination should be allowed of the question of whether in the absence of a special relationship (i.e., financial power, strong position in the market, etc., of the foreign corporate group member) the borrowing company might not have completely refrained from making investment for which it borrowed the money." "

5. Similarly this Court in case of CIT v. Tata Autocomp Systems Ltd. [2015] 374 ITR 516/230 Taxman 649/56 taxmann.com 206, had observed as under;

"7. We find that the impugned order of the Tribunal inter alia has followed the decisions of the Bombay Bench of the Tribunal in cases of VVF Ltd. v. Dy. CIT (supra) and Dy. CIT v. Tech Mahindra Ltd. (supra) to reach the conclusion that ALP in the case of loans advanced to AEs would be determined on the basis of rate of interest being charged in the country where the loan is

received/consumed. Mr. Suresh Kumar the learned counsel for the Revenue informed us that the Revenue has not preferred any appeal against the decision of the Tribunal in VVF Ltd. v. Dy. CIT (supra) and Dy. CIT v. Tech Mahindra Ltd. (supra) on the above issue. No reason has been shown to us as to why the Revenue seeks to take a different view in respect of the impugned order from that taken in VVF Ltd. v. Dy. CIT (supra) and Dy. CIT v. Tech Mahindra Ltd. (supra). The Revenue not having filed any appeal, has in fact accepted the decision of the Tribunal in VVF Ltd. v. Dy. CIT (supra) and Dy. CIT v. Tech Mahindra Ltd. (supra). "

6. Before closing this issue we may note that the tribunal in the impugned judgment has made certain observations suggesting that the identification of the "tested party" is imperative while applying other methods from comparison for transfer pricing and not while applying CUP method. Our non-consideration of the revenue's Appeal in the present case, should not be seen as putting our seal on such observations of the tribunal. In other words, we keep such question open to be examined in an appropriate case. In the present case, independent of such observations of the tribunal, we find that the conclusions arrive at, are based on evidence on record which conclusions call for no interference."

28. In our view, the decision of Hon'ble Bombay High Court as well as Delhi High Court are not applicable to the facts of the present case as both the Hon'ble Courts had not examined the issue of whether the FCCDs were in the nature of debt or equity and hence, there was no occasion to bench mark the interest payable on FCCD. In the present case, the issue involved is benchmarking of interest to be paid or payable of FCCDs before its conversion to equity. As mentioned elsewhere in the order, there would be no occasion for the assessee to repay the loan to it's A.E (on account of the nature of FCCD), therefore, the currency in which loan was taken or to be paid would not be relevant for the purpose of determining the interest rate. Therefore also, the decision in the case of Cotton Natural (supra) is not applicable to the present set of unique facts.

29. The next judgment relied upon by the assessee was ADAMA India (P) Ltd. Vs. DCIT reported in (2017) 78 taxmann.com 75 is not applicable to the facts of the present case. As the coordinate bench had decided the issue based on the above two noted decisions of Hon'ble High Courts without discussing and deciding the nature of CCD. In our view, this decision is also distinguishable on account of the fact that the Bench has not examined the real nature of the CCD and therefore, this decision is not applicable to the facts of the case.

30. Similarly, the decision of Delhi Tribunal in the case of Assotech Moonshine Urban Developments (P.) Ltd Vs. DCIT reported in (202) 121 taxmann.com 220 is also not applicable to the present case as the Bench has not examined the nature of the instrument issued by the assessee to it's A.E. The decision of Bangalore Bench of the Tribunal in the case of Praxair India (P) Ltd. Vs. ACIT reported in (20220 138 taxmann.com 67 is also not applicable as the Tribunal without examining the nature of CCDs has benchmarked it applying the decision of the Cotton Naturals.

31. For our above said finding of FCCD is debt in nature , we draw support from the decision of NCLT in the case of SGM Webtech Pvt. Ltd Vs. Boulevard Projects Pvt. Ltd MANU/NC/2636/2020 dt.31.01.2020 wherein it was held as under :

> *"By looking at the agreement entered into between the parties, this money has been shown as money paid towards fully and compulsorily convertible debentures for the value mentioned therein, it is not the case of the Corporate Debtor that this money has not come into the account, indeed it is the case of the Corporate Debtor until before this case is filed that this is a long term borrowings as per the balance sheet of the Company and it is also the case of the Corporate Debtor that TDS has been deducted on the interest accrued against the compulsorily convertible debentures held by the applicant.*
>
> *When a party admits a factual aspect stating that applicant is a creditor, debentures are lying in its name and the debt is shown as long term borrowing, then such party cannot take out diametrically opposite stand stating that the debt being shown as capital under FEMA or under some other Regulations, therefore it is not a debt.*
>
> *As to civil rights are concerned, as long as such rights are not prohibited under any law, a rule or definition given in some provision of some other civil law, cannot change the rights agreed between the parties. Here in this case, this Corporate Debtor all through mentioned and shown this claim as a debt in the books of it. In view of the same, today this Corporate Debtor by relying upon some FEMA Regulations cannot say that it is not a debt, it is an equity invested by the applicant.*
>
> *As to this aspect, the applicant counsel has stated that the submission of the debtor counsel saying that this money is shown as equity in the Form filed before RBI is factually incorrect, because debt and equity are separately shown in the said Form.*

As to the judgment refereed by the Resolution Professional counsel, to our understanding, this ratio has been decided with regard to the Guideline IV (i) r/w IV (ii) of the Guidelines for Issue of Cumulative Convertible Preference Shares and Guideline No. 8 and 11 of the Employees Stock Option Guidelines. These Guidelines being in relation to Employees Stock Option Guidelines and Issue of Cumulative Convertible Preference Shares, this ratio cannot be extended to say that debentures also fall under this category. Therefore, we believe that the ratio decided in Narendra Kumar Maheshwari (supra) is not applicable to the present facts of the case.

Moreover, since Insolvency and Bankruptcy Code, 2016 has overriding effect over other enactments, the debentures being treated as debt under IBC, this value of debentures shall be treated as debt, not as equity. In any event, since it is not the case of this Corporate Debtor that it is not a debt as per its books, the debtor counsel cannot come out with a new argument saying that these debentures shall be treated as equity.

Another argument advanced by the Resolution Professional counsel is that the nature of investment being compulsorily convertible debentures, the applicant cannot claim the value of the investment except to the extent of interest. As to this point, if a company is a running company and regularly paying interest, it is understandable that this RP Counsel can come with this argument to say that it is not repayable to the claimant because over a period of time these debentures would be converted into equity. This situation wil arise when this debt is converted into equity as on the date of admission. But as on the date of admission, when the debentures are not matured for conversion and the debtor already defaulted paying interest, where is the question of treating it as equity. Assuming this RP counsel argument is correct, when a Company has become insolvent, the only right available to the debentures holder is to claim his money from the proceeds of the Corporate Debtor, that being the situation, today this Corporate Debtor cannot say that since a clause is not there for repaying the principal amount to the applicant, it cannot be treated as debt and it has to be treated as equity.

Basically, we do not find any sense in this argument because when a company is in the process of winding up or company has become insolvent, as on the date of admission, whatever is shown as debt in the books of the Corporate Debtor, such debt shall continue as debt. Whoever is shown as shareholder, he/she/it will continue as shareholder, in this case, as on the date of admission of the petition, this is shown as debt.

It is true that in the agreement, that after 15 years, these debentures would become equity, but until such time the Corporate Debtor shall pay fixed returns to this applicant. The RP merely by showing this, the RP Counsel cannot come with an argument to say that this is to be treated as equity for redemption of debentures has not been envisaged in the agreement. At the time of winding up or admission of a case under IBC, if the debentures are not matured and not convertible for the period for redemption is not complete, they shall be treated as debentures and the consequence is, it will remain as debt. Same is the case here, debentures are not matured for conversion, interest shall be paid through coupons periodically. That has also not complied with.

In view thereof, this application is hereby allowed directing the Resolution Professional to admit the claim as Financial Debt as envisaged under Section 5(8) (c) of the Insolvency and Bankruptcy Code, 2016. Accordingly, this application is allowed.

32. Further, we may fruitfully rely upon the decision of the Tribunal in the case of ACIT Vs. CAE Fright Training (India) Pvt. Ltd. IT(TP)A 63/Bang/2015, had held CCD as debt, whereby it was held as under :

"7.1. Core theme and arguments of the Transfer Pricing Officer is nonexistent Thin Capitalization concept in Indian context. Towards this objective the Transfer Pricing Officer has re- characterized the Compulsory Convertible Debentures (debt) in to equity as has been seen in discussion above. For this the Transfer Pricing Officer also makes reference to the Foreign Direct Investment (FDI) Policy and the Reserve Bank of India (RBI) Policy in respect of fund infusion from foreign sources in to Indian economy. Misplaced understanding of the Government Policy and its purpose has only created a smokescreen of confusion hiding the truth and reality of the matter. (Kindly refer, Para- 3.1. to 3.6. on Page- 10 to 12 of the Transfer Pricing Order for AY: 2009-10).

7.2. Even though statutorily the Transfer Pricing Officer was not entitled to delve in to anything else other than determination of arm's length price of the given transactions, it should have been understood that the needs requirements and purpose under the Income Tax Act and those of the FDI and RBI Policies do not stand opposite to each other or

contradict each other. However, they just need to be understood in their respective contexts.

7.3. The purposes of the FDI and RBI Policies are aimed at controlling fund inflow from abroad in the form of debt. They have no problem if the infusions of funds are in the form of equity. In order to ensure this, these policies just declared that Optionally or Partially Convertible Debentures and other Hybrid Instruments, because their conversion in to equity at a future appointed date remains an uncertainty being non compulsive in nature, shall be treated as debt and not equity. This was just to prevent such non compulsive instruments to be used for fund infusion that the Government brought in clarity in this regard.

7.4. As far as Compulsory Convertible Debentures are concerned, the Government Policy accepted and allowed it to be used for fund inflow from abroad even as a debt, as at a later appointed date it will compulsorily and unambiguously be converted in to equity. Therefore the Government clarified that till such time its conversion in to equity happens and till such time it continues its identity as a debenture, it shall continue to be a valid form of fund infusion from abroad. The Government Policy only defined non-admissibility and non-validity of Optionally or Partially Convertible Debentures and other Hybrid Instruments as means of fund infusion vis a vis admissibility and validity of Compulsory Convertible Debentures as an instrument and means of fund infusion from abroad. This was the need and requirement in a Regulatory environment and for Regulatory purposes. Nowhere did the Government Policy redefined or re-characterized the nature of a Compulsory Convertible Debenture as equity.

7.5. As far as need and requirement under the Income Tax Act is concerned it is enough to understand that the Government nowhere said in the given situation that a Compulsory Convertible Debenture is equity even at the time of its inception and during its continuity as a debenture prior to its compulsory and actual conversion in to equity at the appointed date. That being the case, purposes of Income Tax Act just requires to determine the nature of receipt and expense and decide the taxability of the resultant income. Thus, in the case of a Compulsory Convertible Debenture the nature of its value is that of a debt and once it is converted into equity at the appointed date, its value is that of an equity. The resultant expense therefore correspondingly will

be that of an interest and a dividend, in that sequence. Reading anything more in to the Government's Policy through RBI and FDI Policies is not only misleading but also purposive.

33. During the course of argument, the ld.AR had submitted that the TPO cannot recharacterize the nature of FCCD as equity to loan. In this regard, we have already mentioned that as per the assessee, FCCDs are debt in nature till its conversion into equity. Therefore, there is no recharacterization of the transaction by the TPO / Assessing Officer. Further, the TPO/Assessing Officer cannot act as a silent spectator and accept the nature of transaction as claimed by the assessee, though there were contradiction on the characterisation by assessee with that of terms and conditions of issuance of the instrument. The economic substance of the document is different than what had been claimed by the assessee. This is in tune with the decision of the Hon'ble Delhi High Court in the case of EKL Appliances (supra) wherein it was noted as under:-

> *"17. The significance of the aforesaid guidelines lies in the fact that they recognize that barring exceptional cases, the tax administration should not disregard the actual transaction or substitute other transactions for them and the examination of a controlled transaction should ordinarily be based on the transaction as it has been actually undertaken and structured by the associated enterprises. It is of further significance that the guidelines discourage re-structuring of legitimate business transactions. The reason for characterization of such re-structuring as an arbitrary exercise, as given in the guidelines, is that it has the potential to create double taxation if the other tax administration does not share the same view as to how the transaction should be structured.*
>
> *18. Two exceptions have been allowed to the aforesaid principle and they are (i) where the economic substance of a transaction differs from its form and (ii) where the form and substance of the transaction are the same but arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner."*

34. Even as per the assessee, the FCCDs are debt till it is converted into equity. Hence, there is no recharacterization by the Assessing Officer/TPO. Assuming the case of the assessee that FCCDs are equity then we must look into the substance over the form of the instrument,

which can be ascertained by looking into its terms and conditions of allotment. As discussed hereinabove, the terms and conditions clearly show that the FCCDs are debt till its conversion. Yet another reason to above conclusion is that there is no recharacterization of the instrument by the Assessing Officer as there is no concept of paying the interest on the equity by the company to its holder under the Companies Act or under Income Tax Act or under the Accounting standards. The reliance of the assessee on the RBI policy for the non- convertible debenture is not relevant. In view of the above, we do not find any substance in the argument of the assessee that the Assessing Officer has recharacterized the nature of transaction.

35. Accordingly, we hold that FCCDs are debt, therefore, the benchmarking done by the learned lower authorities are correct by applying LIBOR plus 200 points, which is in consonance with the RBI guidelines issued for the purposes of FDI.

36. We may also draw support from the decision of co-ordinate Bench of the Tribunal in the case of Maanaveeya Development & Finance P. Ltd. in ITA Nos.134/Hyd/2017 and others dt.14.12.2021 wherein at Para 6 it was held as under :

> *"6. Learned counsel has quoted a catena of case law regarding adoption of interest rate going by currency involved in the international transactions. We note that the same are not relevant to this instant issue since we have already held that the currency involved herein is not "Euro" only. The alleged "safe harbor" rules (supra) also do not pertain to these four assessment years. We thus affirm the TPO's identical action in all these four assessment years adopting "LIBOR + 200" interest rate coming to 2.9% as against that claimed @ 11% at assessee's behest. These four taxpayer appeals in ITA Nos.134 & 565/Hyd/2017 for A.Ys 2011-12 and 1507 and 1682/Hyd/2018 for the A.Ys 2013-14 and 2014-15; respectively, are dismissed. The Revenue's former two cross appeals in ITA Nos.149/Hyd/2017 and 1506/Hyd/2018 for A.Ys 2011-12 and 2013-14 raising in the instant sole ground are accepted."*

37. In view of our above decision, we do not find any merits in the appeal of the assessee. Accordingly, order of ld.CIT(A) is upheld and the grounds raised by the assessee are dismissed.

7. Hence, respectfully following the above decision, we dismiss ground No.2.

8. With respect to the remaining grounds, the ld. AR has submitted the ld.CIT(A) has extended the benefit of DTAA and our attention was drawn to the provision of Article 11(7) of the India – Cyprus DTAA which is to the following effect :

> *"Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt-claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Agreement."*

8.1 The ld. AR had further submitted that the order passed by the ld.CIT(A) is not in accordance with the law and therefore, the benefit of section 11(7) of India Cyprus DTAA is required to be given to the assessee and rate of interest is required to be restricted.

8.2. In this regard, the ld.CIT(A) had dismissed the ground of the assessee by observing as under :

> *"8. The material available on record has been perused and I am in agreement with the stand taken by the AO. The appellant is an investment company having two subsidiaries in India i.e., M/s. Watermarke Residency Pvt. Ltd. (WRPL) and M/s. Watermarke Villas Pvt. Ltd. (WVPL). The appellant received a sum of Rs.16,72,31,170/- from WRPL towards interest income on investments in the form of fully completely convertible debentures (FCCDs). Tax was deducted at source by WRPL @ 42.024%. In the original return of income, the appellant declared income of*

Rs.16,72,31,170/- and arrived at tax payable of Rs.7,23,44,204/-, being the amount of TDS made by WRPL. However, the appellant revised the return by claiming benefit of special rate of tax @ 10% relying on Article 11(2) of the India-Cyprus Double Tax Avoidance Agreement (DTAA) and offering nil income with a claim for refund of Rs.5,47,74,900/-.

8.1 The case was referred to the Transfer Pricing Officer (TPO) and the total TP adjustment made on international transactions was of Rs.13,98,41,656/-. The AO has correctly taxed the excess interest income of Rs.13,98,41,656/- @ 40% relying on Article 11(7) of the India-Cyprus DTAA. The view taken in other assessment years is not relevant as the principle of res judicata is not applicable to income tax proceedings.

8.2 As pointed out by the AO, as per Article 11(7) of the DTAA, if the interest paid is not at ALP, then the benefit of special rate of tax will not be available to the excess interest paid and the same will be taxed at normal rates prescribed under the Act. Section 92(1) is clear that any income arising from an international transaction shall be computed having regard to the ALP. Essentially, ALP is about price and not rate of tax.

8.3 The AO has also referred to the second proviso to Section 92C(4) and stated that when the expenditure of an AE is adjusted downwards, the income of the other AE should not be recomputed in order to avoid double taxation. Therefore, the protection is available only for the income / expenditure. The same does not apply to the rate of tax. As facts show no income has been recomputed in the case of the appellant. Due to TPO adjustment, the interest expenditure in the hands of WRPL will reduce. The appellant has already received the interest income and Section 92C(4) bars the adjustment in the income of the appellant. In the case of the appellant, only the rate of tax has been changed.

8.4 The case laws cited by the appellant are not applicable as the facts in the case of the appellant are different.

8.5 In view of the above, the action of the AO is justified and the addition made is sustained. Accordingly, the grounds of appeal no. 2 to 6 are dismissed."

9. It was the further contention of the ld. AR that only the interest as computed is required to be charged @ 10% and the remaining interest, if any, can be charged under the business head, if permissible under law. It was submitted that since no specific

finding is given by the lower authorities, the action on the part of the ld.CIT(A) is not in accordance with the law.

10. Per contra, the ld. DR had opposed the ground and submitted that the Assessing Officer had rightly charged the tax under 11(7) of the Act.

11. We have heard the rival submissions and perused the material on record. Admittedly, the interest as computed by the Assessing Officer pursuant to the application of applying LIBOR + 200 points was confirmed by the Tribunal in the case of Watermarke Residency Limited. Now the issue is that whether only 10% of the gross amount of the interest is required to be taxed in the hands of the assessee and the remaining interest amount cannot be taxed as per clause 7 of Article 11 of the DTAA or not ? In our view, the conjoint reading of Clauses 2 and 7 of Article 11 of DTAA made it abundantly clear that interest paid over and above the interest mentioned in clause 7 of Article 11 of DTAA, shall be chargeable at Income Tax rate as applicable in Contracting State namely, India, as mentioned in Article 11(7) of DTAA.

12. In light of the above, we do not find any error in the order passed by the lower authorities. During the course of argument, the ld. AR had vaguely argued that excess amount of the interest paid / received by the assessee shall be chargeable under the head "Income from business" and thereafter, it may be taxed under the other provisions of DTAA. In our view, the Assessing

Officer / ld.CIT(A) cannot be changed the characteristics of "head of income" when the assessee itself has admitted that the amount received by it was in the nature of interest only and hence, it would be improper either on the part of the Assessing Officer or the assessee to change or recharacterize the amount received by it as 'business income' within the meaning of DTAA. Once the assessee itself admits that the amounts received by it on the FCCDs were in the nature of "Interest income", then the same cannot be converted into "income from business" and therefore, the submissions of the ld. AR are without any basis and hence, the same are rejected. Accordingly, the appeal of the assessee is dismissed.

13. In the result, the appeal of assessee in ITA No.347/Hyd/2019 is dismissed.

14. Now we will deal with the only ground raised by Revenue.

14.1. Before us, ld. DR had submitted that education cess should be over and above the rate of tax mentioned in clause 2 of Article 11 of the DTAA.

14.2 On the other hand, the ld. AR relied upon the order of ld.CIT(A).

15. We have heard the rival submissions and perused the material on record. We find that ld.CIT(A) had decided this ground in favour of assessee vide para 11 of his order by holding as under :

> *"11. The material available on record has been perused. I am in agreement with the stand taken by the appellant that the tax rate charged under the DTAA is the final tax rate applicable. Considering the submissions of the appellant and the decision of the Hon'ble Supreme Court in the case of Azadi Bachao Andolan and ANR and the decision of the Hon'ble A.P. High Court in the case of Visakhapatnam Port Trust, the Assessing Officer is directed to delete the addition made towards surcharge and education cess. The additional grounds of appeal no.7 and 8 are dismissed."*

15.1. The tax has been defined in Article 3 of India Cyprus Treaty as under :

> *"(k) the term "tax" means Indian or Cyprus tax, as the context requires, but shall not include any amount which is payable in respect of any default or omission in relation to the taxes to which this agreement applies or which represents a penalty or fine imposed relating to those taxes;"*

15.2. Clause 2 of Article 11 of DTAA provides under :

> *"2. However, such interest may also be taxed in Contracting State in which it arises, and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10% of the gross amount of the interest."*

15.3. From the perusal of definition of 'tax' provided under Article 3 of DTAA, and clause (2) of Article 11, it is abundantly clear that tax shall not exceed 10% of the gross amount of the

interest. Assuming for the purpose of arriving at applicable rate of tax, if we consider that the education cess is a part of tax which has now been clarified by the recent amendment made to the Finance Act, 2022, then also the tax was required to be restricted to the cap of 10% mentioned in 11(2) of DTAA. In that eventuality also, the applicable rate of tax cannot exceed the rate of tax mentioned in Article 3(k) r.w. Article 11(2) of the DTAA. Hence, the rate of tax which can be charged from the assessee shall not exceed 10% of the gross total amount of the interest. Our view is also supported by the decision of co-ordinate Bench of the Tribunal in the case of R.A.K. Ceramics, UAE Vs. DCIT reported in (2019) 104 taxmann.com 380 (Hyd.Trib), wherein this Tribunal decided the issue in favour of the assessee by holding as under :

> *"9. The view so taken by the coordinate bench, with which we are in complete agreement, has also been adopted in a large number of cases and including in the context of the India UAE Double Taxation Avoidance Agreement. These cases include Capgemini SA v. Dy. CIT (International Taxation) [2016] 72 taxmann.com 58/ 160 ITD 13 (Mum. - Trib.), Dy. DIT v. J.P. Morgan Securities Asia (P.) Ltd. [2014] 42 taxmann.com 33/[2015] 152 ITD 553 (Mum. - Trib.), Dy. DIT v. BOC Group Ltd. [2015] 64 taxmann.com 386/[2016] 156 ITD 402 (Kol. - Trib.), Everest Industries Ltd. v. Jt. CIT [2018] 90 taxmann.com 330 (Mum. - Trib.), Soregam SA v. Dy. DIT (Int. Taxation) [2019] 101 taxmann.com 94 (Delhi - Trib.) and Sunil v. Motiani v. ITO (International Taxation) [2013] 33 taxmann.com 252/ 59 SOT 37 (Mum. - Trib.). We may add that no contrary decision was cited before us nor any specific justification assigned for the levy of surcharge and education cess. The provisions of the India UAE Double Taxation Avoidance Agreement are in pari materia with the provisions of India Singapore DTAA which was subject matter of consideration in DIC Asia Pacific's case (supra). We, therefore, have no reasons to take any other view of the matter than the view so taken by the coordinate benches. Respectfully following the same, we uphold the plea of the assessee and direct the Assessing Officer to delete the levy of surcharge and education cess on the facts of this case. Once this relief is allowed, the taxes payable by the assessee are the same as taxes deducted at source and no other grievances survive."*

15.4. Hence, respectfully following the decision cited supra, we are of the opinion that the ld.CIT(A) has decided the issue in accordance with the law and accordingly the appeal of the Revenue is dismissed.

16. In the result, the appeal of Revenue in ITA No.488/Hyd/2019 is dismissed.

17. To sum up, both the appeals of assessee and Revenue are dismissed.

Order pronounced in the Open Court on 25th April, 2023.

Sd/-	**Sd/-**
(RAMA KANTA PANDA)	**(LALIET KUMAR)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Hyderabad, dated 25th April, 2023.
TYNM/sps
Copy to:

S.No	Addresses
1	M/s. Fairfield Developments Limited, C/o. Vijayarghavan & Associates LLP., Plot No.54, Sagar Society, Road No.2, Banjara Hills, Hyderabad.
2	Dy. Commissioner of Income Tax, International Taxation – 1 Hyderabad.
3	CCIT (IT) (SZ), Bengaluru
4	DR, ITAT Hyderabad Benches
5	Guard File

By Order