**Income Tax Appellate Tribunal - Delhi**

Tmw Aspf I Cyprus Holding Company ... vs Dcit (International Taxation), ... on 9 August, 2019

INCOME TAX APPELLATE TRIBUNAL

DELHI BENCH "I-2": NEW DELHI

BEFORE SHRI AMIT SHUKLA, JUDICIAL MEMBER

AND

SHRI O.P. KANT, ACCOUNTANT MEMBER

ITA No.879/Del/2016

Asstt. Year: 2011-12

DCIT (International Taxation) Circle 3 (1)(1), New Delhi ----------(Appellant)

V/S

M/s. TMW ASPF i Cyprus Holding Company Ltd., C/o Deloitee Hasking & Sells LLP,

7th Floor, Bldg. 10, Tower-B, DLF, Cyber City Complex, DLF City Phase - II,

Gurgaon 122 002 Haryana (PAN AACCT6680J)----------(Respondent)

CO 200/Del/2018

(Arising out of ITA 879/Del/2016)

Asstt. Year 2011-12

M/s. TMW ASPF i Cyprus Holding Company Ltd., C/o Deloitee Hasking & Sells LLP,

7th Floor, Bldg. 10, Tower-B, DLF, Cyber City Complex, DLF City Phase - II,

Gurgaon 122 002 Haryana (PAN AACCT6680J)----------(Respondent)

V/S

DCIT (International Taxation) Circle 3 (1)(1), New Delhi ----------(Appellant)

Assessee by: Shri Kanchan Koushal, Adv.

Department by: Shri H.K. Choudhary, CIT ( DR )

Date of Hearing 05-08-2019

Date of pronouncement 09-08-2019

ORDER

PER AMIT SHUKLA, J.M The aforesaid appeal has been filed by the revenue and cross objection by the assessee against the directions issued by the Dispute Resolution Panel -2(DRP) dated 9.11.2015 for the assessment year 2011-12. Grounds raised by the revenue read as under:

"(i) Whether on the facts and in the circumstances of the case, the DRP erred in holding that as per Article 11(1) and (2) of Indo- Cyprus DTAA, interest income is chargeable to tax on paid basis when the usage of the word 'paid' always includes 'payable' and vice versa.

(ii) Whether on the facts and in the circumstances of the case, the DRP erred in observing that it has been judicially held in various case laws relied upon by the assessee that as per Article 11(1) and (2) of Indo- Cyprus DTAA, interest income is chargeable to tax on paid basis when there are no such findings in any decision cited by the assessee before the Hon'ble DRP.

(iii) Whether on the facts and in the circumstances of the case, the DRP erred in not considering that the Hon'ble Mumbai High Court in the decision dated 09.07.2012 in ITA No 1026 of 2011 in the case of DIT Vs Credit Suisse First Boston (Cyprus) Ltd while examining the Article 11(1)& 11(2) of the Indo Cyprus Treaty held that interest can be said to have accrued on the date on which it was due as per the terms and conditions of the security

(iv) Whether on the facts and in the circumstances of the case, the DRP erred in not considering that under Article 11(1) of the Indo Cyprus DTAA the taxability is of 'interest arising' in a contracting state which is paid to the resident of other contracting state thus laying emphasis on the accrual of interest in a contracting state and the word 'paid' does not necessarily mean actual payment of the interest as also held by the United State Tax Court in Central De Gas Chihuahua Vs Commissioner 102 TC515 (1994) and in Case De La Jolla Park, Inc Vs Commissioner 94TC384(1990).

(v) Whether on the facts and in the circumstances of the case, the DRP erred in deleting the addition of Interest income made to the total income of the assessee on the basis of difference in the arm's length price of the International transaction determined by the TPO merely by observing that interest has not been paid when under the provisions of section 92(1) of the Income Tax Act, actual payment of income is not a condition for substituting the value of international transaction by the ALP of the International Transaction.

(vi) Whether on the facts and in the circumstances of the case, the DRP erred in observing that the imputing interest income shall lead to unintended consequence of erosion of tax base, without paying attention to the fact that the given TP adjustment has resulted in a much higher tax incidence in India in the year under consideration.

(vii) Whether on the facts and in the circumstances of the case, the DRP erred in observing that imputing interest income shall lead to unintended consequence of erosion of tax base, merely on hypothetical basis un backed by any supporting audited financials of the invested companies in India i.e DO Housing Ltd., Supreme Buildcap Pvt. Ltd. and Ritesh Spinning Mills Ltd.

(viii) Whether on the facts and in the circumstances of the case, the DRP erred in summarily deleting the adjustment to the ALP made by the TPO without pointing out any error in the determination of arm's length price of the international transactions by the TPO either in the selection of the most appropriate method or in the application of such method by the TPO.

(ix) Whether on the facts and in the circumstances of the case, the DRP erred in holding that TP provisions are not intended to be applicable In such cases when the Hon'ble Authority for Advance Ruling in the Ruling dated 25 .11.2004 in AAR No 609 of 2003 (2721TR 499 AAR) in the case of Instrumnetarium Corporation held that;

(a) The applicant has no option but to comply with the provisions of the Act including the legislation relating to transfer pricing, namely sections 92 to 92F of the Act with respect to the said transaction of loan.

(b) Whether or not the applicant would charge the interest, as per the principles of the arm's length price, on the said loan advanced to Datex, having regard to its contractual obligation, is a matter for the applicant to consider but for the purposes of the Act the rate of interest will have to be taken as per the principles of arm's length price.

(x) The appellant prays for leave to add, amend, modify or alter any grounds of appeal at the time of or before the hearing of the appeal."

2. The cross objections are in support of the directions given by the DRP.

3. The facts in brief are that TMW ASPF CYPRUS (hereinafter referred to as 'assessee') is a private limited company incorporated in Cyprus and is engaged in the business of making investments in the real estate sector. The company in the year 2008 had made investments in independent third-party companies in India (hereinafter collectively known as 'investee companies') engaged in real estate development vide fully convertible debentures (FCCDs). It was these investments that made the investee companies an associated enterprise of the assessee as per TP provisions. The assessee has also placed before us copy of the agreements concluded between the investee companies and the TMW ASPF. As per the aforesaid agreements, the assessee was entitled to a coupon rate of 4%. Further, post the conversion of the FCCDs into equity shares, the promoter of Indian Companies would buy back at an agreed option price. The option price would be such that the investor gets the original investment paid on subscription to the

FCCDs plus a return of 18% per annum. During the impugned assessment year, the Assessee had received an interest income of Rs.60,46,895/ - from one of the three investee companies and that too only for the first half of the year. No interest was received by the assessee from any other company. As stated by the Ld. Counsel before us that the Assessee Company had sent multiple notices and followed up with the investee companies in relation to the defaults and non compliances with the agreed terms of the agreements. However, no resolution could be sought in this regard. The assessee company on account of the downturn in the real estate market and the fact that the companies were in bad financial position and facing cash crunch, waived its right to receive interest under a mutual agreement with the investee companies.

4. The case of the assessee company was selected for detailed scrutiny and the matter was referred by the Assessing Officer to the Transfer Pricing officer to examine whether the international transactions entered by the assessee during the captioned assessment year were at arm's length or not. The TPO held that the assessee was to earn an assured return of 18% and determined the arm's length price of the coupon rate to be 18%, instead of coupon rate of 4%. Consequently, the TPO computed Arm's Length adjustment with respect to Interest Income adjustments as under: -

| Name of the AE | Amount to be Adjusted |
|---|---|
| Supreme Buildcap Pvt Ltd | Rs.2,25,00,000 /- |
| DD Housing Ltd. | Rs.27 ,89,58,000 /- |
| Ritesh Spinning Mills Ltd | Rs.5,40,00,000 /- |
| TOTAL | Rs. 35,54,58,000/- |

Accordingly, taxable income was revised to Rs.36,75,86,430/- in the draft assessment order by the AO.

5. Aggrieved by the action of the TPO and the consequent addition by the Assessing Officer, assessee filed its objections against the draft assessment order before the DRP. The assessee raised the following contentions:

5.1 The assessee submitted that Ld. TPO has erred in misconstruing the facts of the case, by not appreciating that as per the terms 'of the agreements entered between the Assessee with the investee companies, there are three separate and independent events:

I. Subscription to FCCDs bearing an annual interest of 4%;

II. Conversion of FCCDs into equity at a conversion price on the completion of the specified term or as may be determined by the parties; and III. Post conversion, sale of equity shares to the promoters at a consideration providing annualized 18%/19% return on investment.

5.2 The assessee submitted that the latter two events were future and contingent. The second event, i.e. conversion of FCCDs into equity shares:

- is an independent future event and the debenture subscription agreement clearly provides the conversion mechanism, i.e., the number of equity shares and percentage of equity share capital to be issued to the Assessee on conversion.

- Said debenture subscription agreement specifies that the Conversion ratio would be in accordance with the guidelines issued by Controller of Capital Issues (Reserve Bank of India)

- i.e. NAV of the company is required to be computed on the subscription date to arrive at the conversion ratio.

This clearly demonstrates that the conversion mechanism does not provide for 18%/ 19% rate of return at the time of conversion of FCCDs into equity shares.

5.3 Further, the third event, i. e. sale of converted equity shares to the promoters of the Investee companies is also an independent contingent event as per the terms of shareholder's agreement, which provides an option to the Assessee to sell its converted shares (i.e. subsequent to second event) to the promoters of the Investee companies, at an option price that shall fetch the Assessee a return on investment of 18%119%.

5. 4 The Assessee reiterated that:

• Agreed coupon rate of 4% has not been received by the Assessee during the subject year, except for a half year interest from one of the investee company, and in the subsequent four years.;

• Investee companies have requested for the waiver of interest due to bad financial position/ cash crunch and delayed project execution, and such request has been accepted by the Assessee.

• Part of the FCCDs held in DD Housing were sold to a third party during the subject year at a loss and in the very next year, another lot was sold at par;

• Converted shares in Supreme were sold to a third party in the subsequent year at par.

Therefore, none of the investments bore any premium to the assessee on sale of securities. These were either sold at a loss or at par to the third parties. Ld. AO erred in disregarding the fact that the interest on FCCDs has been waived by the mutual agreement of the parties and hence, the Assessee had no right to receive the interest income.

5.5 Further, ASPF I is a tax resident of Cyprus and entitled to the beneficial provisions of the DTAA. Article 11 of the DTAA provides that interest income can be taxed in India only on fulfilment of the twin conditions of 'arising' and 'payment'. The relevant extracts of the said Article are reproduced herein below:

"1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State".

The above clause makes it clear that for taxing the interest income in the hands of a non-resident, it is necessary that such an income must be 'paid' and notional or accrued interest income cannot be brought under the purview of Article 11 of the DTAA. Reliance is placed on following case laws:

- DIT v. Siemens Aktiengesellschaft (Born HC) (ITA no.124

of 2010)

- CSC Technology Singapore Pte. Ltd. v. ADIT [2012] 19

taxmann.com 123 (Delhi ITAT)

- DCIT v. UhdeGmbh [1996] 54 TTJ 355 (Mum ITAT)

National Organic Chemical Industries Ltd. v. DCIT [2006] 5 SOT 317 (Mum ITAT) • Johnson & Johnson v. ADIT [2013J 32 taxmann.com 102 (Mum ITAT) 5.6 The assessee further contended that TPO erred in benchmarking the ALP of interest with that of loan without appreciating that the investments made by assessee are akin to equity and not to loan. It should be noted that ASPF I was incorporated for the purposes of investing in real estate companies. It has been clearly drawn in the agreements that it subscribed the FCCDs as an investor and not as a lender and therefore, getting its stake capitalized in the Indian companies is its objective rather than earning interest on debentures. The FCCDs are not to be repaid but retained by converting into equity shares, therefore, it cannot be said to be a borrowing or loan. Reliance in this regard is placed on the decision of Special 'Bench of ITAT Ahmedabad in the case of Ashima Syntex Ltd. v. Assistant Commissioner of Income- Tax (100 ITD 247) [2006]. 5.7 Further, TPO has erred by ignoring the fact that increase in interest rate charged by the assessee would lead to erosion of tax base in India. As per the Explanatory Memorandum explaining the Finance Bill 2002, the intention of introducing the transfer pricing law in India was expressed to avoid shifting of income from India avoid shifting of income from India by manipulating prices charged or paid in international transactions, thereby eroding the country's tax base. In the present case, the assessee charges interest from the Indian AEs and the interest income of the Assessee is taxed @ 10% as can be confirmed by its tax return. The Indian AEs would be claiming an expense of such interest paid to the assessee @ 33.99%."

6. The DRP concurred with the contentions of the Assessee and held as under:

"6.1 DRP has duly examined the issue. The relevant facts are that the non-resident assessee company has invested by way of subscription to Fully Compulsorily Convertible Debentures (FFCD) in three Indian Companies which are in the business of real estate. In its return of income, the assessee has declared interest income received from only one investee company and that too pertaining to period of part of the year. The case of the assessee is that since investee companies were in economic slowdown, interest receivable was waived by mutual understanding whereas case of the AO/TPO is that interest @18% and not @4% is chargeable to tax on all the investments in FCCD held by the assessee.

6.2 The panel has noted that as per Article 11 (1) and (2) of Indo- Cyprus DTAA, interest income is chargeable to tax on paid basis. It has been judicially held so in various case laws relied upon by the assessee. In the present case, even if it is assumed that interest accrues to the assessee, it has not been paid to the assessee. Therefore, interest income cannot be brought to tax in hands of the assessee unless it is paid to the assessee.

6.3 Further, the panel finds force in contention of the assessee that imputing interest income in hands of non-resident assessee when it has not been claimed by the Indian payer to have accrued/ arisen or paid in favour of the assessee shall lead to unintended consequences of erosion of tax base as such interest expenses shall be tax deductible in hands of Indian company which are subject to tax @30% whereas it shall be taxable in hands of recipient assessee @1 0% as DTAA. TP provisions are not intended to be applicable under such circumstances.

6. In view of above discussion, the panel is of considered view that TP adjustment is not called for in the present case. The AO/TPO is directed accordingly, Objections are allowed."

7. Aggrieved by the aforesaid finding the Revenue department has filed an appeal before us.

8. After drawing our attention, the relevant observation made by the TPO, Ld. CIT DR submitted that here in this case the assessee has incurred losses due to non receipt of interest and consequent to that it had to sell its investment to other 3rd parties on a loss. No independent entity in the market shall invest its resources in such high risk and if such investment is made which carries maximum risk then same has to be compensated at a higher value and here in this case, assessee has agreed to have only 4% of interest. The market rate of corporate loans of this kind fetches interest income at the rates anywhere between 16% to 30%, but the assessee has agreed for a much lesser compensation @ 18%. However, the assessee has received interest of Rs. 1,21,28,480/- @ 4%. Assessee has advanced deemed loan to its AE through internal accruals thereby implying that its funds were used to advance loans. An independent person would definitely expect the maximum return on its investment. Since Assessee Company is a tested party the same needs to be benchmarked independently with comparable uncontrolled transactions. He further submitted that the interest paid also includes payable and there was specific provision that 18% would payable and therefore, tax should be levied on accrual basis. He further submitted that benchmarking has to be done on entire amount which is payable with independent third parties, whether such payment is justified or not, if it is an international transaction. Here in this case, the debentures have been issued by AE and therefore it has to be benchmarked. Since 18% was payable therefore, entire interest needs to be benchmarked. It would not be a proper interpretation that only paid / received is to be benchmarked. Thus, order of the TPO should be confirmed. Thus order of the TPO should be confirmed.

9. The Ld. Counsel for the assessee, Shri Kanchun Kaushal filed Paper book and made detailed oral & written submissions before us. He submitted that the assessee being a non resident is entitled to the benefit of the India- Cyprus Double Taxation Avoidance Agreement ['DTAA'] by virtue of Section 90(2) of the Income-tax Act, 1961. It was further argued that Article 11 of the India-Cyprus DTAA provides that interest income can be taxed in India only on fulfilment of the twin conditions of 'arising' and 'payment'.

He then read out Article 11(1) of the India-Cyprus which states that; "1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State." It was, accordingly, submitted by him that the aforesaid clause makes it clear that for taxing the interest income in the hands of a non-resident, it is necessary that the twin conditions of 'accrual' as well as 'payment' are satisfied. Accordingly, if the twin conditions are not satisfied, the taxability of such interest in the hands of a non-resident under Article 11 of DTAA does not arise.

10. In support of the aforesaid contentions the Ld. Counsel first relied upon the decision of the coordinate Mumbai bench in the case of DDIT v. Siemens Aktiengesellschaft (2009) taxmann.com 1019 (Mumbai - Trib.) wherein the tribunal while deciding the issue whether the commissioner of income tax (appeals) was correct in directing the AO to tax royalty income on accrual basis had held that the royalty and fees for technical services should be taxed in the hands of the assessee on receipt basis. The Ld. Counsel submitted that the Article pertaining to Royalty was similarly worded as the Article pertaining to interest in the India-Cyprus DTAA. He also brought to our notice that the aforesaid decision of the ITAT stood approved by the Hon'ble Bombay High in the case of DIT v. Siemens Aktiengesellschaft (ITA124 of 2010), wherein Hon'ble Bombay High Court observed and held as under:

"The Income Tax Appellate Tribunal referring to para-I to 3 under Article IIX-A of the Double Taxation Avoidance Treaty with the Federal Germany Republic as per Notification dated 26th August 1985 held that the assessment of royalty or any fees for technical services should be made in the year in which the amounts are received and not otherwise. Counsel for the Revenue relied upon the Special Bench decision of the Tribunal in the assessee's own case, which in our opinion, has no relevance to the facts of the present case, as it relates to the period prior to the issuance of Notification dated 26th August 1985. In this view of the matter the decision of the Income Tax Appellate Tribunal in holding that the royalty and fees for technical services should be taxed on receipt basis cannot be faulted."

11. The Ld. Counsel then relied on the decision of Mumbai ITAT in the case of Pramerica ASPF II Cyprus Holding Ltd. v. DCIT [2016] 179 TTJ 211 (Mumbai - Trib.) wherein the assessee company was incorporated in Cyprus and was engaged in making investment in real estate development companies in India, much like the assessee in the case at hand. The Assessing Officer in Pramerica (Supra) made an addition on the ground that interest income earned on aforesaid income was liable to be assessed on accrual basis. The Ld. Counsel also pointed out that the assessee in the aforesaid decision of Pramerica (Supra), took a similar argument and represented before the ITAT that Article 11 of the India- Cyprus DTAA pertaining to Interest Income fastens a tax liability only on payment of interest Income. The ITAT while agreeing with the arguments of the assessee in Pramerica (Supra) held:

"The expression paid used in article 11 (1) of the India-Cyprus Double Taxation Avoidance Agreement (DTAA) to mean that the interest income in question is liable to be taxed on payment/ receipt basis and not on accrual basis, as sought to be made out by the Assessing Officer. Thus, in principle, the plea of the assessee is upheld."

He also placed on record the decision of the Hon'ble Bombay High Court approving the aforesaid decision of the ITAT in the case of Pramerica. The Hon'ble Bombay High Court in CIT v. Pramerica ASPF II Cyprus Holding Limited (ITA No. 1824 of 2016) had framed the following question of law:

"Whether on the facts and circumstances of the case and in law, the ITAT is correct in directing the Assessing Officer to accept the interest income returned by the assessee on cash basis whereas the A. O. has made additions on the ground that interest income was liable to be assessed on accrual basis ?".

The Hon'ble Bombay High Court dismissed the appeal filed by the revenue department and held that followed its earlier decision in Siemens (Supra) to hold that taxability in a case where the article is worded in the aforesaid manner, taxability can only be fastened on receipt of payment. Relevant Paragraph has been reproduced: Thus, while interpreting similar clause of Indo-German DTAA in relation to taxing royalty or fees for technical services, this Court had confirmed the decision of tribunal holding that such service can be taxed only on receipt. This decision was later on followed in Income Tax Appeal No. 1033/11 dated 20/11/2012 and thereafter in Income Tax Appeal No.2356/ 11 and connected Appeals vide the order dated 07/03/2013.

9. On the same principle, the Appeal is dismissed."

12. The Ld. Counsel then proceeded to submit that the issue can also be examined from the angle of the TDS provisions. It was submitted that the Hon'ble Supreme Court in the case of GE Technology Centre (P.) Ltd. V. CIT [2010] 327 ITR 456 has held that when a credit afforded by, or a payment made by, an Indian resident, to a non-resident, does not trigger the taxability of that income in the hands of recipient, the tax deduction liability does not come into play at all. The tax at source is attracted at the very first instance when the income accrues to the payee. Accordingly, in this case by virtue of Article 11 of the Indian-Cyprus DTAA the tax liability of the payer can only be fastened at the time of payment and not before that. The Ld. Counsel stated that the decision to withhold tax from a credit or payment to a non-resident is not taken in vacuum. It is taken in the light of the tax liability of the non-resident in respect of the amount in question. Essentially, therefore, the provisions of Section 195 are to be read in conjunction with the charging provisions under the statue, as also in conjunction with the relevant double taxation avoidance agreements which override these charging provisions. He also placed reliance on the decision of Saira Asia Interiors (P.) Ltd. V. Income Tax Officer [[2017] 79 taxmann.com 460] wherein, the tribunal while examining the decision rendered in the case of GE Technology (Supra) has held that the mere fact that an Indian resident credits the amount of royalty payable to an Italian resident does not trigger taxability under article 13 of the Indo-Italian DTAA and it is only at point of time when payment takes place, that income embedded In payment becomes taxable. Relevant Para reads as under:  As for the point of time of crediting the amount payable to non resident, i.e. "at the time of credit of such income to the account of payee", the royalty so paid by the assessee was not taxable in the hands of the resident, for the simple reason that, in terms of article 13 of Indo Italian DTAA- which is reproduced above for the ready reference, taxability of royalty is dependent on the payment by the resident of a contracting state and receipt of the same by the resident of the other

contracting state. Unless, therefore, the actual payment takes place, the taxability under article 13 of Indo Italian DTAA does not arise. In other words, the mere fact that an Indian resident credits the amount of royalty payable to an Italian resident does not trigger taxability under article 13 of the Indo Italian DTAA. Such is also the view taken by a series of decisions by the coordinate benches, including the decision in the case National Organic Chemical Industries Ltd [(2005) 96 TTJ 765 (Mum)], with which we are in respectful agreement. When the royalty so credited by the assessee is not taxable at the time of credit of such amount to the account of payee, in the light of law laid down by Hon'ble Supreme Court in the case of GE Information Technology (supra), it does not give rise to any tax withholding obligations under section 195 (1) either."

13. It was accordingly argued that when the income is not taxable in terms of Section 4 of the Act, then chapter X cannot become applicable at all. Section 92 of the Act provides for computing the 'income' arising from an 'international transaction' with reference to the ALP. Therefore, only the interest income chargeable to tax can be subject to transfer pricing in India. Accordingly, by imposing transfer pricing adjustment on interest which, is not chargeable in terms of the Act read with DTAA the TPO has sought to assess notional income and has thus exceeded its jurisdictional powers. Reliance in this regard was placed on the Bombay High Court decision of Vodafone India Services (P.) Ltd. V. Union of India [2014] 5-taxmann.com 300. And our attention was drawn to following paragraphs:

"40 It was contended by the Revenue that in view of Chapter X of the Act, the notional income is to be brought to tax and real income will have no place. The entire exercise of determining the ALP is only to arrive at the real income earned i.e. the correct price of the transaction, shorn of the price arrived at between the parties on account of their relationship viz. AEs. In this case, the revenue seems to be confusing the measure to a charge and calling the measure a notional income. We find that there is absence of any charge in the Act to subject issue of shares at a premium to tax.

45 Chapter X of the Act is a machinery provision to arrive at the ALP of a transaction between AEs. The substantive charging provisions are found in Sections 4, 5, 15 (Salaries), 22 (Income from house property), 28 (Profits and gains of 14 business), 45 (Capital gain) and 56 (Income from other Sources). Even Income arising from International Transaction between A.E. must satisfy the test of Income under the Act and must find its home in one of the above heads i.e. charging provisions. This the revenue has not been able to show."

14. It was accordingly submitted that the alleged adjustment on account of interest made by the TPO, except to the extent actually received by the appellant, cannot be said to have been chargeable to tax in the hands of the Assessee. Therefore, Ld. TPO's computation of ALP under section 92 of the Act read with Article 11 of DTAA to the said extent is not justified. It was further submitted that the Ld. TPO can examine only to the extent of interest received by Assessee from Investee Companies and not otherwise. Since the assessee never received the agreed coupon rate in the subject year or any other amount from the investee companies; by virtue of applicability of Article 11 of the Indo-Cyprus DTAA, no income is chargeable to tax in India and therefore, any adjustment on account of application of Transfer

Pricing provisions becomes purely academic. Further, the Ld. Counsel submitted that the term Paid will not include payable. Reliance in this regard was placed on the decision of the ITAT, Chennai in the case of DCIT v. Inzi Control India Limited [2019] 101 taxmann.com 112. Relevant Para is reproduced below:

"First contention of the ld. Departmental Representative is that term "paid" used in clause (1) will include "payable" amount also. To buttress this argument) reliance has been placed on the judgment of Hon'ble Apex Court in the case of Palam Gas Service (supra). Said case concerned interpretation of Section 40(a)(ia) of the Act where the :- 9 -: ITA No. 1820/CHNY /2015 word "payable" occurred and the word "paid" was not mentioned. Their lordships held that word ''payable'' appearing in Section 4o(a)(ia) of the Act would include paid amount also. In our opinion, this judgment would not aid the Revenue in interpreting, the word ''paid' as appearing clause (1) of Article 13 of the DTAA. Terms used in treaties are not to interpreted in the manner which terms are used in a legislative edict in the form of a statute or law. Hon'ble Apex Court had noted as under in its judgment in the case of UOI vs. Azadi Bachao Andolan (2006) 263 ITR 706, which. throws light on the manner which a treaty is to be interpreted."

15. Lastly, the Ld. AR brought to the attention of this Bench that the benchmarking done by the TPO by adopting the rate of 18% to make an adjustment in the present case is from the controlled transaction between the assessee and the Investee companies and for this reason alone, the adjustment made is not at all justified and hence has to be deleted.

16. It was further submitted that the TPO ought to have considered that the Conversion of FCCDS and sale of equity shares to promoters at a consideration providing annualized 18% return on investment were independent future events with the debenture subscription agreement providing specific conversion mechanism.

17. We have heard the rival submissions and also perused the relevant findings given in the impugned orders and the materials referred to before us. The assessee is a Cyprus based company engaged in the business of making investment in real estate sectors via fully convertible debentures. It was due to these investments in the investee companies that they are treated as associated enterprises as per the provisions of TP. As per the agreement between the investee companies and the assessee, the assessee was entitled to a coupon rate of 4% and further post the conversion of FCCDs into equity shares, the promoters of the Indian Companies would buy back shares at an agreed option price. The option price was stipulated to be such that the investor gets the original investment paid on subscription to the FCCD's plus a return of 18% per annum. Undisputedly, the assessee has only received interest income of Rs. 60,46,895/- from one of the investee companies and that too only for the half of the year. No actual interest other than this amount has been received by the assessee from any other investee companies. The TPO has made the adjustment on the ground that assessee was to earn an assured return of 18% and accordingly, determined the arm's length price by taking the coupon rate to be 18% instead of coupon rate of 4%.

18. As per the terms of agreements entered between the assessee with the investee companies there were three separate and independent events:

I. Subscription to FCCDs bearing an annual interest of 4%; II. Conversion of FCCDs into equity at a conversion price on the completion of the specified term or as may be determined by the parties; and III. Post conversion, sale of equity shares to the promoters at a consideration providing annualized 18%/19% return on investment.

The last two of the events were futuristic and contingent. The sale of converted equity shares to the promoters of the investee companies as per the terms of shareholder's agreement provided an option to the assessee to sell its converted shares to the promoters of the investee companies at an option price that shall fetch the assessee a return on investment of 18%. It has been brought on record that investee companies have requested for the waiver of interest due to bad financial position/cash crunch and delayed project in the real estate and such a request has been accepted by the assessee. Part of the FCCDs held in one of the investee company was sold to a third party during the year at a loss. Thus, none of the investment bore any premium to the assessee on sale of securities. They were either sold at a loss or at par to third parties. The details of investment made by the company in FCCDs and the interest received and factum of waiver of interest are reproduced hereunder:-

| Investee | Initial date of subscribing to FCCDs | Amount of investment during the year FY 2010-11 01.04.2010 to 31.3.2011 [In Rs.] | Conversion of debenture during the AY 2011-12 | Interest received | Waiver of interest |
|---|---|---|---|---|---|
| DD Housing Ltd. | 16-Oct-2006 | 146,82,00,000 | Not converted | Nil | Waiver of interest with effect from Sep 16, 2008 |

| | | | | | | |
|---|---|---|---|---|---|---|
| | | | | (including interest for the full subject year) | | |
| Supreme Buildcap Pvt. Ltd. | 22-Dec-2006 | 75,00,00,000 | Converted on 11-May-2010 | Nil | Waiver of interest with effect from Sep 15,2009 (including interest for 1 month & 11 days pertaining to the subject year) | |
| Ritesh Spinning Mills Ltd. | 16-Feb-2007 | 30,00,00,000 | Not converted | 60,46,895 | Waiver of interest with effect from (For Half Sep 15, 2010 the year) granted orally as per mutual agreement (including second instalment for the subject year) | |
| | | | | 60,46,895 | | |

19. One of the main contention raised before us by the Ld. Counsel that assessee being a non resident and Cyprus based company therefore it was entitled to the benefit of India Cyprus DTAA Article 11(1) of India-Cyprus DTAA reads as under :-

"Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State."

20. The aforesaid para envisages that for taxing the interest income in the hands of a non-resident, it is necessary that the interest should arise in a contracting state, i.e., twin conditions of accrual as well as the payment are to be satisfied. If there is no accrual or actual payment received then same is to be decided within the scope of Article 11(1). What the TPO/AO have sought to tax is that, assessee was supposed to receive interest of 18%, if the contingent event would have arisen, i.e., if in the event, the option was exercised by the assessee to sell its converted shares to the promoters of investee company at an option price then it would have given the return of 18%. Thus, entire edifice of the TPO/AO was based on fixation of contingent event which assessee was supposed to receive. It is also matter of record no such conversion was actualised and assessee remained invested even during the year under consideration. The transfer pricing adjustment has been made on this hypothetical amount of interest receivable. Whether such notional income can be brought to tax even under the transfer pricing provision, has been dealt by the Hon'ble Bombay High Court in the case of Vodafone India Services (P) Ltd. vs. Union of India (supra), wherein their Lordships have held that even income arising from international transaction must satisfy the test of income under the Act and must find its home in one of the charging provisions. Here in this case, nowhere the TPO/AO has been able to establish that notional interest satisfy the test of income arising or received under the charging provision of Income Tax Act. If income is not taxable in terms of section 4, then chapter X cannot be made applicable, because section 92 provides for computing the income arising from international transactions with regard to the ALP. Only the interest income chargeable to tax can be subject matter of transfer pricing in India. Making any transfer pricing adjustment on interest which has neither been received nor accrued to the assessee cannot be held to be chargeable in terms of the Income Tax Act read with Article 11(1) of DTAA. Here it cannot be the case of accrual of interest also, because none of the investee companies have acknowledge that any interest payment is due, albeit they have been requesting for waiving of interest of even coupon rate of 4%, leave alone the return of 18% which was dependent upon some future contingencies. Assessee despite all its efforts has acceded to such request. Further, in the India Cyprus DTAA wherein similar phrase has been used pertaining to FTS and Royalty in India Cyprus DTAA, Hon'ble Bombay High Court held that assessment of royalty or FTS should be made in the year in which amount have actually received and not otherwise. The coordinate bench of Mumbai ITAT in the case of Pramerica ASPF II Cyprus Holding Ltd. vs. DCIT (supra) on exactly similar set of facts, addition on account of notional interest was made; the Tribunal has held that the interest income in question can only be taxed on payment /receipt basis. The relevant observation has already been incorporated above. The Hon'ble Bombay High Court has confirmed the said finding. Similar view has been taken by the ITAT

Chennai Bench in the case of DCIT vs. Inzi Control India Limited (supra). Thus, in view of Article 11(1) we hold that, only the interest which has actually been received can only be subject matter of taxation and no TP adjustment can be made on some hypothetical receivable amount which was contingent upon certain event which has actually not been taken place during the year. Thus, the order of the Direction of the DRP is upheld and the grounds raised by the revenue are dismissed.

21. Since CO is in support therefore the same is also to be treated as allowed.

21. In the result appeal of the revenue is dismissed and CO IS allowed.

Order Pronounced in the open court on 09th August, 2019.

| | |
|---|---|
| sd/- | sd/- |
| (O.P. KANT) | (AMIT SHUKLA) |
| ACCOUNTANT MEMBER | JUDICIAL MEMBER |

Dated: 09/08/2019

Veena

Copy forwarded to

1. Applicant
2. Respondent
3. CIT
4. CIT (A)
5. DR:ITAT

ASSISTANT REGISTRAR

ITAT, New Delhi