IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

R/TAX APPEAL NO. 1440 of 2008

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COMMISSIONER OF INCOME TAX-I

Versus

CORE EMBALLAGE LIMITED

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Appearance:
M R BHATT & CO.(5953) for the Appellant(s) No. 1
DARSHAN R PATEL(8486) for the Opponent(s) No. 1
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CORAM: **HONOURABLE MR. JUSTICE J.B.PARDIWALA**
and
HONOURABLE MS. JUSTICE NISHA M. THAKORE

Date : 21/01/2022

ORAL ORDER

(PER : HONOURABLE MS. JUSTICE NISHA M. THAKORE)

1. This is an appeal filed by the Revenue Department under Section 260A of the Income Tax Act, 1961 (for short, 'the Act') challenging the order dated 20.02.2008 passed by the Income Tax Appellate Tribunal, Ahmedabad Bench "C", Ahmedabad in ITA No.2858/Ahd/2007 for the A.Y. 2001-02.

2. The substantial question of law which is raised by the Revenue department for our consideration, reads as under:

> *"Whether the Appellate Tribunal is right in law and on facts in directing to allow Rs.2.70 Crores being interest payable to ICICI Ltd. u/s. 43B of the Income Tax Act, 1961 (Act)?"*

3. The facts which emerges from the record are briefly narrated as under:

3.1 The return of income came to be filed by the respondent/ original assessee company on 30.10.2001 thereby declaring

total loss of Rs.3,71,26,980/-. During the course of filing of return, the assessee company had also furnished Profit & Loss A/c Book and Balance sheet etc. The Assessing Officer had processed and scrutiny assessment was made under Section 143(3) read with Section 145(3) of the Act and had passed assessment order dated 30.03.2004 thereby determining total income of an amount of Rs.11,52,285/-.

3.2 Thereafter, on verification of the record, the Assessing Officer found that the assessee company had claimed deduction of an amount of Rs.5,00,87,126/- under the head of the interest paid to ICICI Bank on Term Loan. The said amount also included the value of Rs.27,00,000/- equity shares of Rs.10 each issued by the company in lieu of accumulated interest for an amount of Rs.2,70,00,000/-. This lead to reopening of the assessment of the year under consideration which was followed by a Notice dated 20.03.2006 under Section 148 of the Act. The said notice was served on the assessee on 24.03.2006.

3.3 In response to the said Notice issued under Section 148 of the Act, the respondent – assessee company had submitted return of income on 17.04.2006 thereby declaring enhanced loss of Rs.18,22,40,379/- which included an amount of Rs.3,71,26,977/- towards the business loss not being considered and the unpaid municipal tax and land revenue of Rs.11,52,285/-. Once again Notices under Section 143(2) and 142(1) of the Act were issued and served upon the respondent-assessee company. The same was responded by the assessee – company by submitting objections vide letter dated 22.12.2006. Ultimately, the Assessing Officer found that the

assessee was required to explain why the interest of an amount of Rs.2,70,00,000/- payable to the ICICI on Term Loan was required to be disallowed in view of Section 43B of the Act more particularly, when no actual payment by cash or cheque was made and in fact, it can only be treated as an adjustment of payment by issuing shares to the company. Ultimately, the Assessing Officer rejected the objections raised by the respondent – assessee company by disallowing the aforesaid amount and adding it into the total income of the assessee for taxation purpose.

3.4 Being aggrieved and dissatisfied with the aforesaid order of the Assessing Officer, the respondent – assessee company preferred an appeal before the Commissioner of Income Tax (Appeals)- V, Ahmedabad, which was registered as Appeal No.CIT(A)-V/DCIT Cir.1/211/2006-07. The CIT(A) after carefully examining the issue and on perusal of the record arrived at a finding that this was a case where payment of interest has been made by issue of fully paid up shares to ICICI Ltd.. It further found that in case of issue shares, there can be no occasion to pay the amount again in any other manner and thus, agreed with the contention of the respondent – assessee company regarding disallowance made by the Assessing Officer under Section 43B of the Act as incorrect and accordingly, partly allowed the appeal.

3.5 Being aggrieved and dissatisfied with the aforesaid order dated 29.04.2007 passed by the CIT(A), Ahmedabad, the Revenue department preferred an appeal bearing ITA No.2858/ Ahd/2007 before the Income Tax Appellate Tribunal, Ahmedabad Bench “C”, Ahmedabad. The limited dispute which

was raised by the Revenue Department in appeal regarding disallowance of Rs.2,70,00,000/-, towards the interest payable to ICICI Ltd. in terms of Section 43B of the Act, was examined by the ITAT Appeals. Upon careful consideration of the submissions made by the respective parties, the ITAT agreed with the view of the CIT(A) that the shares have been allowed in the year under consideration in lieu of the outstanding liability of the assessee is ultimately a payment of the amount and consequently such payment results into discharge of the liability in the year under consideration. Thus, the ITAT find no error of law against the order of the CIT(A) in deleting the aforesaid addition made by the Assessing Officer and thereby rejected the aforesaid appeal of the Revenue. Hence, the Revenue department has approached this Court.

4. We have heard Mr. Manish Bhatt, the learned Senior Counsel assisted by Mr. Munjaal Bhatt, the learned counsel appearing for the appellant – Revenue department and Mr. Darshan Patel, the learned counsel appearing for the respondent – assessee company. We have also carefully examined the record and have also perused the judgments/decisions relied upon by the learned counsel appearing for the respective parties. The only short issue which falls for our consideration relates to the provisions of allowance under Section 43B of the Act.

5. Mr. Manish Bhatt, the learned Senior Counsel for the department has made a strenuous effort by referring to Section 43B of the Act and has submitted that the intention of the legislation is the '*actual payment by way of cash or cheque'*. The issuance of shares as against the outstanding

liability of interest of the assessee company for the year under consideration does not fall in the category of actual payment of interest and has therefore, submitted that such amount does not qualify for deduction under Section 43B of the Act. It was further urged that this was not a case where the Assessing Officer had examined an issue and recorded satisfaction in the original assessment by referring to Explanation – 1 of Section 147. The learned Senior Counsel for the department submitted that the Assessing Officer has rightly assumed jurisdiction for reopening the assessment in terms of powers conferred under Section 148 of the Act. The learned Senior Counsel has further referred to Explanation – 3C to Section 43B of the Act, which declares that any deduction in respect of any amount being the interest payable which has been converted into loan or borrowing, then the same shall *"not be deemed to have been actually paid"*. Accordingly, he submitted that the Assessing Officer was justified in seeking reopening of the original assessment of the respondent – assessee company.

6. On the other hand, Mr. Darshan Patel, the learned counsel appearing for the respondent – assessee company has referred to and relied upon the findings and reasons arrived at by the CIT(A) as well as the ITAT, Ahmedabad and has submitted that no error of fact or law is found, which calls for any interference of this Court in appeal under Section 260A of the Act. It is further submitted that there are concurrent findings of facts as well as law and in absence of any substantial questions of law being framed by the Revenue department, the present appeal is not required to be entertained and is required to be rejected summarily.

7. The learned Counsel for the respondent – assessee by referring to Explanation – 3C to Section 43B of the Act, has submitted that the application of explanation 3C to section 43B of the act is misconstrued in the facts of the case on hand as the same deals with the situation of conversion of interest into the loan or borrowings. It was further submitted that Explanation – 3C to Section 43B of the Act was introduced retrospectively with effect from 01.04.1989. Thus, it is submitted that there is nothing in the provision much less with the retrospective effect, by which the conversion of interest into shares has been described as not amounting to actual payment for the purposes of Section 43B of the Act. The learned counsel appearing for the respondent – assessee has placed reliance upon the decision of the Supreme Court in the case of ***M.M. Aqua Technologies Ltd. Vs. Commissioner of Income Tax, Delhi-III*** passed in the Civil Appeal Nos.4742-4743 of 2021.

8. By referring to the aforesaid decision, the learned Counsel appearing for the respondent – assessee has placed much reliance upon Para-20 by drawing analogy in the facts of the case where the Supreme Court has treated issuance of debentures as against the “actual payment” of interest acceptable more particularly, when ultimately it extinguished the liability to pay interest.

9. We have extensively heard the learned counsel appearing for the respective parties and have also perused the record, relevant provisions of law and the decisions relied. The only short issue involved in this appeal is that whether the issuance of equity shares as against the payment of

outstanding interest can be considered for deduction under Section 43B of the Act.

10. At this stage, it would be appropriate to reproduce relevant provision of law:

> *"43B. Certain deductions to be only on actual payment – Notwithstanding anything contained in any other provision of this Act, a deduction otherwise allowable under this Act in respect of —*
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> *xxx xxx xxx*
>
> *(d) any sum payable by the assessee as interest on any loan or borrowing from any public financial institution or a State financial corporation or a State industrial investment corporation, in accordance with the terms and conditions of the agreement governing such loan or borrowing, or*
>
> *xxx xxx xxx*
>
> *shall be allowed (irrespective of the previous year in which the liability to pay such sum was incurred by the assessee according to the method of accounting regularly employed by him) only in computing the income referred to in section 28 of that previous year in which such sum is actually paid by him:*
>
> *Provided that nothing contained in this section shall apply in relation to any sum which is actually paid by the assessee on or before the due date applicable in his case for furnishing the return of income under sub-section (1) of section 139 in respect of the previous year in which the liability to pay such sum was incurred as aforesaid and the evidence of such payment is furnished by the assessee along with such return."*

11. The Supreme Court in the case of ***M.M. Aqua Technologies Ltd. (Supra)*** had an occasion to deal with Section 43B more particularly, Explanation – 3C of the Act. The relevant paragraphs are reproduced as under:

> *"17. Section 43B was originally inserted by the Finance Act, 1983 w.e.f. 1st April, 1984. The scope and effect of the newly inserted provision, at that point, was explained by the Central Board of Direct Taxes [**"Board"**] in Circular No.372/1983 dated 8th December, 1983 as follows:*
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> > *"35.2 Several cases have come to notice where taxpayers do not discharge their statutory liability such as in respect of excise duty, employer's contribution to provident fund,*

Employees State Insurance Scheme, etc., for long periods of time, extending sometimes to several years. For the purposes of their income-tax assessments, they claim the liability as deduction on the ground that they maintain accounts on mercantile or accrual basis. On the other hand, they dispute the liability and do not discharge the same. For some reasons or the other, undisputed liabilities also are not paid.

35.3 To curb this practice, the Finance Act has inserted a new section 43B to provide that deduction for any sum payable by the assessee by way of tax or duty under any law for the time being in force or any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees shall irrespective of the previous year in which the liability to pay such sum was incurred, be allowed only in computing the income of that previous year in which such sum is actually paid by the assessee.

35.4 The section also contains an Explanation for the removal of doubts. The Explanation provides that where a deduction in respect of any sum aforesaid is allowed in computing the income of any previous year, being a previous year relevant to the assessment year 1983-84, or any earlier assessment year, in which the liability to pay such sum was incurred by the assessee, the assessee shall not be entitled to any deduction under section 43B in respect of such sum on the ground that the sum has been actually paid by him in that year. In other words, an assessee who has already been allowed deduction of a liability on account of the tax or duty or in respect of any sum payable as contribution to any fund for the assessment year 1983-84, or any earlier year in which the liability to pay was incurred, cannot, in respect of that liability, be allowed a deduction in the assessment year 1984-85, or any subsequent year on the ground that he has actually made a payment towards such liability in that year."

18. As has been pointed out hereinabove, the Finance Act, 2006 inserted Explanation 3C w.e.f. 1st April, 1989. The scope and effect of this provision was explained by the Board in Circular No.14/2006 dated 23rd December, 2006, as follows:

"16.2 It has come to notice that certain assessees were claiming deduction under section 43B on account of conversion of interest payable on an existing loan into a fresh loan on the ground that such conversion was a constructive discharge of interest liability and, therefore, amounted to actual payment. Claim of deduction against conversion of interest into a fresh loan is a case of misuse of the provisions of section 43B. A new Explanation 3C has, therefore, been inserted to clarify that if any sum payable by the assessee as interest on any loan or borrowing, referred to in clause (d) of section 43B, is converted into a loan or borrowing, the interest so converted, shall not be deemed to be actual payment.

> *16.3 This amendment takes effect retrospectively from 1st April, 1989 i.e. the date from which clause (d) was inserted in section 43B and applies in relation to the assessment year 1989-90 and subsequent years."*

19. The object of Section 43B, as originally enacted, is to allow certain deductions only on actual payment. This is made clear by the non- obstante clause contained in the beginning of the provision, coupled with the deduction being allowed irrespective of the previous years in which the liability to pay such sum was incurred by the assessee according to the method of accounting regularly employed by it. In short, a mercantile system of accounting cannot be looked at when a deduction is claimed under this Section, making it clear that incurring of liability cannot allow for a deduction, but only "actual payment", as contrasted with incurring of a liability, can allow for a deduction. Interestingly, the 'sum payable' referred to in Section 43B(d), with which we are concerned, does not refer to the mode of payment, unlike Proviso 2 to the said Section, which was omitted by the Finance Act, 2003 w.e.f. 1st April, 2004. The said Proviso reads as follows:

> *"Provided further that no deduction shall, in respect of any sum referred to in clause (b), be allowed unless such sum has actually been paid in cash or by issue of a cheque or draft or by any other mode on or before the due date as defined in the Explanation below clause (va) of sub-section (1) of section 36, and where such payment has been made otherwise than in cash, the sum has been realised within fifteen days from the due date."*

20. This being the case, it is important to advert to the facts found in the present case. Both the CIT and the ITAT found, as a matter of fact, that as per a rehabilitation plan agreed to between the lender and the borrower, debentures were accepted by the financial institution in discharge of the debt on account of outstanding interest. This is also clear from the expression "in lieu of" used in the judgment of the learned CIT. That this is so is clear not only from the accounts produced by the assessee, but equally clear from the fact that in the assessment of ICICI Bank, for the assessment year in question, the accounts of the bank reflect the amount received by way of debentures as its business income. This being the fact-situation in the present case, it is clear that interest was "actually paid" by means of issuance of debentures, which extinguished the liability to pay interest.

21. Explanation 3C, which was introduced for the "removal of doubts", only made it clear that interest that remained unpaid and has been converted into a loan or borrowing shall not be deemed to have been actually paid. As has been seen by us hereinabove, particularly with regard to the Circular explaining Explanation 3C, at the heart of the introduction of Explanation 3C is misuse of the provisions of Section 43B by not actually paying interest, but converting such interest into a fresh loan. On the facts found in the present case, the issue of debentures by the assessee was, under a rehabilitation plan, to extinguish the

liability of interest altogether. No misuse of the provision of Section 43B was found as a matter of fact by either the CIT or the ITAT. Explanation 3C, which was meant to plug a loophole, cannot therefore be brought to the aid of Revenue on the facts of this case. Indeed, if there be any ambiguity in the retrospectively added Explanation 3C, at least three well established canons of interpretation come to the rescue of the assessee in this case. First, since Explanation 3C was added in 2006 with the object of plugging a loophole – i.e. misusing Section 43B by not actually paying interest but converting interest into a fresh loan, bona fide transactions of actual payments are not meant to be affected. In similar circumstances, in K.P. Varghese v. ITO, (1981) 4 SCC 173, this Court construed Section 52 of the Income Tax Act as applying only to cases where 'understatement' is be found – an 'understatement' is not to be found in the literal language of Section 52, but was introduced by this Court to streamline the provision in the light of the object sought to be achieved by the said provision. This Court, therefore, held:

> *13. Thus it is not enough to attract the applicability of sub-section (2) that the fair market value of the capital asset transferred by the assessee as on the date of the transfer exceeds the full value of the consideration declared in respect of the transfer by not less than 15 per cent of the value so declared, but it is furthermore necessary that the full value of the consideration in respect of the transfer is understated or in other words, shown at a lesser figure than that actually received by the assessee. Sub-section (2) has no application in case of an honest and bona fide transaction where the consideration in respect of the transfer has been correctly declared or disclosed by the assessee, even if the condition of 15 per cent difference between the fair market value of the capital asset as on the date of the transfer and the full value of the consideration declared by the assessee is satisfied. ....*
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> *xxx xxx xxx*
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> *15. It is therefore clear that sub-section (2) cannot be invoked by the Revenue unless there is understatement of the consideration in respect of the transfer and the burden of showing that there is such understatement is on the Revenue. Once it is established by the Revenue that the consideration for the transfer has been understated or, to put it differently, the consideration actually received by the assessee is more than what is declared or disclosed by him, sub-section (2) is immediately attracted, subject of course to the fulfilment of the condition of 15 per cent or more difference, and the Revenue is then not required to show what is the precise extent of the understatement or in other words, what is the consideration actually received by the assessee. That would in most cases be difficult, if not impossible, to show and hence sub-section (2) relieves the Revenue of all burden of proof regarding the extent of understatement or concealment and provides a statutory measure of the consideration received in respect of the transfer. It does not create any fictional receipt. It does not deem as receipt something which*

> *is not in fact received. It merely provides a statutory best judgment assessment of the consideration actually received by the assessee and brings to tax capital gains on the footing that the fair market value of the capital asset represents the actual consideration received by the assessee as against the consideration untruly declared or disclosed by him. This approach in construction of sub-section (2) falls in line with the scheme of the provisions relating to tax on capital gains. It may be noted that Section 52 is not a charging section but is a computation section. It has to be read along with Section 48 which provides the mode of computation and under which the starting point of computation is "the full value of the consideration received or accruing". What in fact never accrued or was never received cannot be computed as capital gains under Section 48. Therefore sub-section (2) cannot be construed as bringing within the computation of capital gains an amount which, by no stretch of imagination, can be said to have accrued to the assessee or been received by him and it must be confined to cases where the actual consideration received for the transfer is understated and since in such cases it is very difficult, if not impossible, to determine and prove the exact quantum of the suppressed consideration, sub-section (2) provides the statutory measure for determining the consideration actually received by the assessee and permits the Revenue to take the fair market value of the capital asset as the full value of the consideration received in respect of the transfer."*

12. Thus, the Supreme Court found that Explanation – 3C was squarely attracted against the outstanding interest had not actually being paid, but instead a new credit entry of loan appeared, bringing the case within the express language of Explanation – 3C. The Court further held that what is required to be considered is the extinguishment of liability to pay the interest in the facts of each case. It is not the case of the department that by virtue of equity shares being offered as against the outstanding interest has infact not extinguished the liability to pay the interest to that extent. As against that, the finding of fact as recorded by the Tribunal below, the outstanding amount of interest to the tune of Rs.2,70,00,000/- payable to the ICICI Ltd. was extinguished by offering shares to which a receipt was also issued by the ICICI Ltd. vide letter dated 03.09.2001. Thus, this is a case where the payment of

interest has been made by issue of fully paid up shares to ICICI Ltd.

13. We agree with the view taken by the CIT(A) as confirmed by the ITAT that it is not a case of conversion of outstanding interest into the loan so that the same could be allowed only on the actual payment, more particularly, when as acknowledge by ICICI Ltd. the defaulted interest stands extinguished having realized the fully paid up shares. Consequently, there is no further outstanding interest to be paid by the assessee company in future as it stands extinguished in the year under consideration Section 43B is hereby held to be attracted in the facts of the case.

14. In view of the above, concurrent findings recorded by the CIT(Appeals) and by the ITAT, the question of law raised by the department does not deserve any further consideration. The said question also being no more *res-integra,* it could not be said that the present appeal involves any question much less substantial question of law. It may be noted that the Appeal under section 260A of the Act, could be admitted only on the High Court being satisfied that the case involves a substantial question of law.

15. In the result, this appeal fails and is hereby dismissed.

(J. B. PARDIWALA, J)

(NISHA M. THAKORE,J)

NEHA