IN THE HIGH COURT OF KARNATAKA AT BENGALURU

DATED THIS THE 1ST DAY OF OCTOBER, 2021

PRESENT

THE HON'BLE MRS.JUSTICE S.SUJATHA

AND

THE HON'BLE MR. JUSTICE RAVI V. HOSMANI

I.T.A.No.684/2015

BETWEEN :

PR. COMMISSIONER OF INCOME TAX-VI,
CENTRAL REVENUE BUILDINGS,
QUEENS ROAD, BANGALORE-560 001. ...APPELLANT

(BY SRI JEEVAN J. NEERALGI, ADV. A/W
SRI T.N.C.SRIDHAR, ADV. FOR SRI E.I.SANMATHI, ADV.)

AND :

M/s SUBEX LTD.,
RMZ ECOWORLD,
DEVARABISANAHALLI,
OUTER RING ROAD,
BANGALORE-560 037.
PAN: AABCS 9255R. ...RESPONDENT

(BY SRI CHYTHANYA K.K., ADV.)

THIS INCOME TAX APPEAL IS FILED UNDER SECTION 260-A OF INCOME TAX ACT 1961, ARISING OUT OF ORDER DATED 19.06.2015 PASSED IN ITA NO.689/BANG/2014, FOR THE ASSESSMENT YEAR 2008-2009. PRAYING TO DECIDE THE FOREGOING QUESTION OF LAW AND/OR SUCH OTHER QUESTIONS OF LAW AS MAY BE FORMULATED BY THE HON'BLE COURT AS DEEMED FIT & SET ASIDE THE APPELLATE ORDERS DATED 19.06.2015 THE ITAT, 'C' BENCH, BENGALURU IN ITA NO.689/BANG/2014 FOR ASSESSMENT YEAR 2008-09.

THIS APPEAL HAVING BEEN HEARD AND RESERVED, COMING ON FOR PRONOUNCEMENT OF JUDGMENT, THIS DAY, **S. SUJATHA, *J***., DELIVERED THE FOLLOWING:

JUDGMENT

This appeal is filed by the Revenue under Section 260A of the Income Tax Act, 1961 ['Act' for short] challenging the order of the Income Tax Appellate Tribunal, "C" Bench, Bangalore ['Tribunal' for short] dated 19.06.2015 passed in ITA No.689/Bang/2014 relating to the assessment year 2008-09.

2. The appeal was admitted by this Court to consider the following substantial questions of law:

> *"1. Whether on the facts and in the circumstances of the case, the Tribunal was justified in holding that foreign currency convertible bonds [FCCBs] are debentures and considered it to be part of 'capital employed' for allowing deduction under Section 35D of the Income Tax Act, 1961 [for short, 'the Act']?*
>
> *2. Whether on the facts and in the circumstances of the case, the Tribunal was justified in treating the foreign exchange gain*

as a gain on capital account and hence allowing it as not taxable?"

3. In this appeal, the focus is on two items deducted from the profit as per the profit and loss account viz., [1] Exchange gain on Foreign Currency Convertible Bonds [FCCBs] reinstatement of Rs.60,75,80,000/- [2] Deduction under Section 35D of the Act amounting to Rs.11,36,59,330/-.

4. The returns for the assessment year 2008-09 was taken up for scrutiny. The Assessing Officer passed an order of assessment under section 143[3] of the Act for the assessment year 2008-09 accepting the claim of the assessee for deduction under Section 35D of the Act on the aforesaid two claims. The CIT in exercise of his powers under Section 263 of the Act exercised the revisional powers on the ground that allowing the aforesaid two claims made by the assessee was erroneous and prejudicial to the interest of the Revenue and held that no evidence was placed to support the

claim. In the absence of evidence, the assessee's claim was rejected. On appeal preferred by the assessee before the Tribunal, the same has been reversed holding that FCCBs are instruments issued to investors for raising funds which is repayable after certain period. It is the debt instrument. The increase or decrease in liability on account of fluctuation in foreign exchange as on the date of the balance sheet would increase or decrease the liability of the assessee and such liability would be on capital account. Therefore, the gain or loss would be on capital account and not taxable. Thus, the Tribunal allowed the appeal answering in favour of the assessee. Being aggrieved, the Revenue has preferred this appeal.

5. In terms of Section 2[12] of the Companies Act, 1956, "debenture" includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not.

6. As per Regulation 2[g] of Foreign Exchange Management [Transfer or Issue of any Foreign Security] Regulations, 2004, "Foreign Currency Convertible Bond [FCCB]" means a bond issued by an Indian company expressed in foreign currency, and the principal and interest in respect of which is payable in foreign currency.

7. Foreign Currency Convertible Bonds as per Regulation 2[b] of Issue of Foreign Currency Convertible Bonds and Ordinary Shares [Through Depository Receipt Mechanism] Scheme, 1993 "Foreign Currency Convertible Bonds" means bonds issued in accordance with this scheme and subscribed by a non-resident in foreign currency and convertible into ordinary shares of the issuing company in any manner, either in whole, or in part, on the basis of any equity related warrants attached to debt instruments.

8. The Commissioner exercising the powers under Section 263 having observed that the assessee on

one hand states that any exchange gain/loss arising on account of restatement of liability with respect to the funds sourced for investments would have to be adjusted in accordance with Section 43A of the Act, on the other hand, states that an amount of Rs.1,929,600,000/- being foreign currency loss was added back in its return of income. The same being contradictory and in the absence of full evidence, the claim of the assessee could not be verified. Thus, the Assessing officer was directed to examine the same and to bring the gain to tax accordingly. The arguments of the learned counsel for the assessee that the loss was not created because it was capital under Section 43A and as such it has been added back being foreign currency loss has some force.

9. At this juncture, it would be apt to refer to paras 38 and 39 of the order of the Tribunal wherein it is held that the factual position that the exchange fluctuation is owing to restatement of FCCBs is not disputed, the admitted position is that FCCBs were

issued for purpose of acquisition of new industrial undertaking and was therefore in that context, reference was made to the judgment of the Hon'ble Apex Court in the case of ***Commissioner of Income-tax, Delhi V/s. Woodward Governor of India [P.] Ltd., [(2009) 312 ITR 254 (SC)]*** wherein, the Hon'ble Apex Court has held thus:

> *"10. As stated above, on facts in the case of M/s Woodward Governor India P. Ltd., the Department has disallowed the deduction/debit to the P&L account made by the assessee in the sum of Rs. 29,49,088.00 being unrealized loss due to foreign exchange fluctuation. At the very outset, it may be stated that there is no dispute that in the previous years whenever the dollar rate stood reduced, the Department had taxed the gains which accrued to the assessee on the basis of accrual and it is only in the year in question when the dollar rate stood increased, resulting in loss that the Department has disallowed the deduction/debit. This fact is*

important. It indicates the double standards adopted by the Department."

10. Analyzing Section 43A [Un-amended] held that "what triggers the adjustment in the actual cost of the assets, in terms of un-amended Section 43A is the change in the rate of exchange subsequent to the acquisition of asset in foreign currency. The Section mandates that any time there is change in the rate of exchange, the same may be given effect to, by way of adjustment of the carrying cost of the fixed assets acquired in foreign currency. Thus, it has been observed that increase or decrease in liability in the repayment of foreign loan should be taken into account to modify the figure of actual cost in the year in which the increase or decrease in liability arises on account fluctuation in the rate of exchange. Thus, the adjustments in the actual cost are to be made irrespective of the date of actual payment in foreign currency made by the assessee. The clarification issued by the Ministry of Finance dated

04.01.1967 is also considered, which *inter alia* reads as under:

> *"2. The Government agrees that for the purposes of the calculation of depreciation allowance, the cost of capital assets imported before the date of devaluation should be written off to the extent of the full amount of the additional rupee liability incurred on account of devaluation and not what is actually paid from year to year. The proposed legal provision in the matter is intended to be framed on this basis."*

11. The arguments advanced on behalf of the Revenue on long term borrowing is not relevant where the question is whether FCCB convertible bonds are debentures or not. The relevant portion of the annual report extract of the assessee-company relating to the assessment year 2008-09 would also throw some light on this issue. Other terms and conditions governing the bonds are shown as under:

"[a] Conversion of the bonds into equity shares at the option of the bond holders at any time after 18th April 2007"

12. In the case of ***Commissioner of Income-tax-4 V/s. Enam Securities [P.] Ltd., [(2012) 345 ITR 64 (Bom.)]***, Hon'ble High Court of Bombay has held that there is a clear distinction between the bonds and debentures on the one hand, and preference share capital on the other. It has been observed that a bond includes "any instrument whereby a person obliges himself to pay money to another on the condition that the obligation shall be void if a specified act is performed, or is not performed, as the case may be" [P.Ramanatha Aiyar's Advanced Law Lexicon 3rd Edition 2005 Page 565 Debt]. Securities typically are regarded as consisting of notes, debentures and bonds. Technically, a 'debenture' is an unsecured corporate obligation while a 'bond' is secured by a lien or mortgage on corporate property. However, in

commercial parlance, the expression "bond" is often used indiscriminately to cover both bonds and debentures. Bonds are in essence interest bearing instruments which represent a loan.

13. In the case of ***R.D. Goyal and Another V/s. Reliance Industries Ltd., [(2003) 1 SCC 81]***, the Hon'ble Apex Court observed that a debenture, as ordinarily understood, in our considered view, would not come within the purview of definition of goods as it is simply an instrument of acknowledgement of debt by the company whereby it undertakes to pay the amount covered by it and till then it undertakes further to pay interest thereon to the debenture-holders. In terms of section 2(46) of the Companies Act, 1956, debenture is a share in the share capital of a company which in turn would mean that it would represent contribution of the share-holder towards the share capital of the company. On the other hand, a debenture is an instrument of

debt executed by the company acknowledging its receipt to repay the same at a specified rate and also carrying an interest.

14. In the case of ***Director of Income-tax V/s. Shree Visheshwar Nath Memorial Public Ch. Trust [(2010) 194 taxman 280 (Delhi)]***, the Hon'ble High Court of Delhi has held thus:

> *"6. For the purposes of Section 13 (1) (d) of the Act, Mr. Sabharwal, learned counsel appearing for the Department, however, has sought to give an altogether different twist to the argument. His submission was that for the limited purpose, i.e. in the context of Section 11 (5) of the Act, the meaning to be assigned to the expression „debenture"; has to be restricted viz. exclude „bond". In support of this submission, he referred to sub Section (5) of Section 11 which specifically deals with the investment in certain specific kinds of bonds. He, thus, argued that only those forms and modes of investments as prescribed under sub*

Section (5) of Section 11 of the Act, would be entitled for exemption for the purposes of Section 11 and the investment in other forms of bonds, by necessary implication of inference had to be excluded from the exemption list. Sub Section 5 of Section 11 deals with the investment in bonds of financial corporation, State Government or Central Government. No doubt, specific provision is made in respect of investment in these particular kinds of bonds, however, that would not mean that when we deal with the investment in „debentures", which also clarifies for exemption, we have to give restrictive meaning to the term „debenture" more particularly when this term is not defined under the Act. It is a trite principle of interpretation that in the absence of any definition given to a particular term in a statute, the meaning which is to be given to the said term is the meaning which is understood in common parlance. The Supreme Court in the case of Noorie Manure Mill, Sambhal Vs. Commissioner, Trade Tax, U.P. (2007), 10 SCC 478 observed as under:-

"In absence of any definition of the term in the statute, the meaning there of as understood in common parlance for the purpose of imposition of tax should be assigned"

Even as per new Gem dictionary, the term 'debenture' includes bond of a company or a corporation."

15. Thus, in the light of these judgments and in terms of the Companies Act, 1956 debenture includes debenture shares and the bonds being interest bearing instruments which represent a loan, FCCB bonds, the instruments issued to investors for raising funds which is repayable after certain period is nothing but a debt instrument. This view is supported by the judgment of the High Court of Madras in case of ***Commissioner of Income-tax-III Chennai V/s. PVP Ventures Ltd., [(2012) 211 Taxman 554 (Mad.)]*** confirmed by the Hon'ble Apex Court by dismissing the SLP [C] C.C.2512/2014 filed by the Revenue. For the reasons

aforesaid, the finding of the Tribunal that the increase or decrease in liability on account of fluctuation in foreign exchange as on the date of the balance sheet would increase or decrease the liability of the assessee and such liability would be on capital account as such, the gain or loss would be on capital account and not taxable cannot be faulted with. Hence, the challenge made by the Revenue on this issue is answered against the Revenue and in favour of the assessee.

For the foregoing reasons, the questions of law raised by the Revenue are answered in favour of the assessee and against the Revenue.

In the result, appeal stands dismissed.

Sd/-
JUDGE

Sd/-
JUDGE

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