

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'D', NEW DELHI**

Before Sh. Amit Shukla, Judicial Member

Dr. B. R. R. Kumar, Accountant Member

(Through Video Conferencing)

ITA No. 3303/Del/2016 : Asstt. Year : 2009-10

M/s Mondon Investments Ltd., C/o-Khiwani & Co., CA, 23/26, 2 nd Floor, East Patel Nagar, Main Market, New Delhi-110008	Vs	DCIT, Circle-3(1), New Delhi
(APPELLANT)		(RESPONDENT)
PAN No. AAFCM8386H		

Assessee by : Dr. Rakesh Gupta, Adv.

Revenue by : Sh. Umesh Takyar, Sr. DR

Date of Hearing: 05.07.2021

Date of Pronouncement: 02.09.2021
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ORDER

Per Dr. B. R. R. Kumar, Accountant Member:

The present appeal has been filed by the assessee against the order passed by the Id. CIT(A)-44, New Delhi dated 06.01.2016.

2. Following grounds have been raised by the assessee:

"1. That having regard to the facts and circumstances of the case, Ld. CIT(A) has erred in law and on facts in confirming the action of Ld. AO in making an adjustment of Rs.4,02,72,970/- as income in the hands of assessee company on account of deemed interest income and that too by recording incorrect facts and findings and without observing the principles of natural justice.

2. That in any case and in any view of the matter, action of Ld. CIT(A) in confirming the action of Ld. AO in making an adjustment of Rs.4,02,72,970/- as income in the hands of assessee company on account of deemed interest income is bad in law and against the facts and circumstances of the case.

3. That having regard to the facts and circumstances of the case, Ld. CIT(A) has erred in law and on facts in confirming the action of Ld. AO in rejecting the analysis followed by the appellant and in determining the price of the impugned transaction on the basis of TPO's order.

4. That having regard to the facts and circumstances of the case, Ld. CIT(A) has erred in law and on facts in confirming the action of Ld. AO in not giving due cognizance to the fact that the appellant had to undertake stewardship activities by financial supporting their group companies and reducing their financial burden.

5. That having regard to the facts and circumstances of the case, Ld. CIT(A) has erred in law and on facts in confirming the action of Ld. AO in not giving due cognizance to the fact that it was a case of business exigency and commercial expediency that associated enterprises had to convert and issue fresh FCD at 0% especially considering that the AEs had not remitted the interest accrued earlier as well.

6. That having regard to the facts and circumstances of the case, Ld. CIT(A) has erred in law and on facts in confirming the action of Ld. AO in making the adjustment in contravention of circular 14/2001 issued by the CBDT and have failed to take into cognizance that charging of interest by the appellant would lead to an overall reduction of tax base in India.

7. That having regard to the facts and circumstances of the case, Ld. CIT(A) has erred in law and on facts in confirming the action of Ld. AO in computing the arm's length price of the international transaction of the

appellant by applying the internal comparable uncontrolled price method.

8. Without prejudice to the above, Ld. CIT(A) has erred in law and on facts in confirming the action of Ld. AO in not treating the investment made by the appellant in the debenture as non performing assets and has accordingly erred in recognizing income on such non performing assets.

9. Without prejudice to the above, Ld. CIT(A) has erred in law and on facts in confirming the action of Ld. AO in application of DTAA between India and Cyprus for computing income chargeable to tax and not appreciating the fact:-

- That the words used in Article 11(1) were "paid to a resident of other contracting state" i.e. the interest income is taxable only on receipt basis.*
- As per the words used in Article 11(7), the provision of DTAA is applicable on the interest amount which would have been agreed upon by the payer and the beneficial owner in the arm's length scenario.*

10. That having regards to the facts and circumstances of the case, Ld. CIT(A) has erred in law and on facts in not reversing the action of Ld. AO in charging the interest u/s 234A, 234B, 234C and 234D of the Income Tax Act, 1961."

3. The assessee is a company incorporated in Cyprus. The assessee on 30th November 2007 subscribed to 15% Fully Convertible Debentures (FCDs) of face value of Rs.100/- each issued by the following Indian entities:

- Apogee Reality Ventures Pvt. Ltd.
- Perigee Reality Ventures Pvt. Ltd.
- Symmetree Realty Ventures Pvt. Ltd.
- Energy Realty Ventures Pvt. Ltd.

4. The debentures were converted into 0% FCDs w.e.f. 01.01.2009. Further, on 23rd December 2009, in addition to the conversion of 15% FCDs into 0% FCDs, the assessee has subscribed to 0% FCDs of face value of Rs.100/- each issued by the above AEs.

5. The TPO held that 15% of the FCDs have been converted into 0% FCDs without assigning any reason, therefore by applying internal CUP as MAM. The TPO charged the interest on FCDs as the same rate of 15% as was being charged prior to 01.01.2009. It has further been submitted that the income generated during the subject year was only interest income on FCDs which was offered to tax at the treaty rate of 10%.

6. Thus, the TPO made adjustments on the interest earned from various investee entities of Rs.4,02,72,970/- which is as under:

Name of the AE	No. Of FCD (15 % FCD)	Face Value of FCD	Interest(A)	Fresh 0 % FCD	Face Value of FCD	Interest(B)	Total Interest Charged (A+B)
ARVPL	13,34,140	13,34,14,000	49,34,490.4	9,648	9,64,800	39252.8	49,73,743.23
PRVPL	62,19,847	62,19,84,700	2,30,04,913.6	NIL	NIL	NIL	2,30,04,913.56
SRVPL	16,74,830	16,74,83,000	61,94,576.7	14,94,971	14,94,97,100	60,82,279.3	1,22,76,855.99
ERVPL	NIL	NIL	NIL	4,291	4,29,100	17,457.9	17,457,90
	Total		3,41,33,980.7			61,38,990.00	4,02,72,970.68

7. Aggrieved the assessee filed appeal before the Id. CIT (A) who held that the word "interest paid" includes "interest payable".

8. The verbatim of the order of the Id. CIT (A) is as under:

Decision

"I have considered the arguments of the Id. AR and had gone through the provisions of Article 11(1). Ld. AR is arguing only on the basis of the word "paid" to resident in Article 11(1). If the contents of Article 11(1) is examined it appears that the word paid includes payable which has been clarified in Article 11(2) where it is written that such interest may be taxable in the contracting state in which it arises. The very purpose of the world arises is to be include receivable also. Therefore, I do not agree with the arguments of the Id. AR that as per Article 11(1) actual interest received can only be taxed under DTAA."

9. This leads to us to adjudicate the moot issue "whether as per Article 11(1) interest paid includes interest payable or not"

10. The Article 11 of agreement between the Government of Republic of India and the Government of Republic of Cyprus for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income reads as under:

ARTICLE 11

INTEREST

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

2. However, such interest may also be taxed in the 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 percent of the gross amount of the interest.

3. Notwithstanding the provisions of paragraph 2, interest arising in a Contracting State shall be exempt from tax in that State, provided that it is derived and beneficially owned by:

(a) the Government, a political sub-division or a local authority of the other Contracting State; or

(b) in the case of India, the Reserve Bank of India, the Export-Import bank of India, the National Housing bank; and

(c) any other institution as may be agreed upon from time to time between the Competent authorities of the Contracting States through exchange of letters.

4. The term "interest" as used in this Article means income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article.

5. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises, "Trough a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the debt claim in respect of which the interest is paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 or Article 14, as the case may be, shall apply.

6. Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person

paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment or fixed base, then such interest shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.

7. 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 only 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."

11. 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 ?".

12. The Hon'ble Bombay High Court dismissed the appeal filed by the revenue department and held that followed its earlier decision in DDIT v. Siemens Aktiengesellschaft (2009) taxmann.com 1019 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:

"8. 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."

13. We have also gone through the order of the Co-ordinate Bench of ITAT in the case of DCIT Vs. TMW ASPF i Cyprus Holding Company Ltd. in ITA No. 879/Del/2016 dated 09.08.2019.

14. In the appeal filed by the revenue against the order of the Id. DRP reads 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."

15. While adjudicating the core issue, it was held as under:

India Cyprus DTAA [Article 11\(1\)](#) of India-Cyprus DTAA:

"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.

16. Since, the matter stands adjudicated by various orders of the Tribunal and Hon'ble Courts that the word "paid" cannot be extended to "payable" in respect of interest under Article 11 of Indo-Cyprus treaty, we hereby allow the appeal of the assessee.

17. In view of the above, the other grounds taken up by the assessee would be academic in nature and hence not being adjudicated.

18. In the result, the appeal of the assessee is allowed.

Order Pronounced in the Open Court on 02/09/2021.

Sd/-

(Amit Shukla)
Judicial Member

Sd/-

(Dr. B. R. R. Kumar)
Accountant Member

Dated: 02/09/2021

Subodh

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

ASSISTANT REGISTRAR

		Date	<u>Initial</u>	
1.	Draft punched on computer	26.08.2021		PS
2.	Draft placed before author	26.08.2021		PS
3.	Draft proposed & placed before the second member			JM/AM
4.	Draft discussed/approved by Second Member.			JM/AM
5.	Approved Draft comes to the Sr.PS/PS			PS/PS
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7.	File sent to the Bench Clerk			PS
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