

**IN THE INCOME TAX APPELLATE TRIBUNAL “F” BENCH, MUMBAI**

**BEFORE SHRI SHAMIM YAHYA, AM AND SHRI PAWAN SINGH, JM**

I.T.A. No. 5004/Mum/2016  
(Assessment Year: 2008-09)

ACIT, Circle-11(3)(2), Room No. 427, Aayakar Bhavan, 4 <sup>th</sup> Floor, M. K. Marg, Mumbai-400 020	Vs.	M/s. Yahoo India Pvt. Ltd. Building No. 12, 6 <sup>th</sup> Floor, Solitaire Corporate Park, Guru Hargovindji Marg, Andheri (E), Mumbai-400 093
PAN/GIR No. AAACY 1252 B		
(Revenue)	:	(Assessee)

C.O. No. 115/Mum/2018  
(Arising out of ITA No.5004/Mum/2016)  
(Assessment Year: 2008-09)

M/s. Yahoo India Pvt. Ltd. Building No. 12, 6 <sup>th</sup> Floor, Solitaire Corporate Park, Guru Hargovindji Marg, Andheri (E), Mumbai-400 093	Vs.	ACIT, Circle-11(3)(2), Room No. 427, Aayakar Bhavan, 4 <sup>th</sup> Floor, M. K. Marg, Mumbai-400 020
PAN/GIR No. AAACY 1252 B		
(Assessee)	:	(Revenue)

<b>Revenue by</b>	:	Shri Rajiv Gubgolra
<b>Assessee by</b>	:	Shri Sriram Seshadri/Amulya K.

<b>Date of Hearing</b>	:	30.08.2018
<b>Date of Pronouncement</b>	:	06.09.2018

**ORDER**

Per Shamim Yahya, A. M.:

This appeal by the Revenue and Cross Objection by the assessee arise out of the order of the learned Commissioner of Income Tax (Appeals)-14, Mumbai ('ld.CIT(A) for short) dated 13.05.2016 and pertains to the assessment year (A.Y.) 2008-09.

2. The grounds of appeal raised in Revenue's appeal read as under:
  1. "Whether on the facts and in the circumstances of the case and in law, the Ld.CIT(A) erred in allowing the interest expenditure on External Commercial Borrowings claimed as a deductible expenditure in A.Y. 2007-08 without appreciating the fact that the share application money pending allotment which includes ECB and interest accrued thereupon has been issued and shares allotted in A.Y. 2008-09.?"
  2. "Whether on the facts and in the circumstances of the case and in law, the Ld.CIT(A) erred in allowing the interest expenditure on the ground that the assessee has converted the outstanding loan and interest accrued thereupon till 31/12/2006 into shares and it was not the case of the AO that the expense in question was incurred due to conversion of loan into shares or in any way pertain to the shares allowed without appreciating the fact that the equity was allowed including accrued interest upto 31/12/2006 to Yahoo Inc, USA and unsecured loan including interest of A.Y. 2007-08 has been converted into shares application money and shares allotted in A.Y. 2008-09.?"
  3. "The appellant prays that the order of the CIT (A) on the above grounds be set aside and that of the A.O. be restored.
3. The grounds of appeal raised by the assessee in Cross Objection ('C.O.' for short) reads as under:
  1. The order passed by the assessing officer ('Ld. AO') and as upheld by the Commissioner of Income Tax (Appeals), to the extent prejudicial to the Appellant, is erroneous in facts and bad in law.
  2. The Ld. AO erred in issuing notice under section 148 of the Income tax Act, 1961 (the Act') based on audit objection raised during the course of audit of assessment work by the Comptroller and Auditor General of India (Revenue Audit).
  3. The Ld. AO failed in initiating reassessment proceedings under section 147 of the Act, without having proper jurisdiction, based on mere change in opinion and without any new material being available on record to form a basis for 'reason to believe' that income has escaped assessment.
  4. The Ld. AO has not demonstrated any failure on the part of the Appellant to furnish material facts, and hence the notice under section 148 of the Act is bad in law and liable to be quashed.

4. In this case, the A.O. completed the assessment order u/s. 143(3) of the Income Tax Act, 1961 ('the Act' for short) vide order dated 31.12.2010. Subsequently, the assessment notice was issued by noting the following reasons:

"It is found that the Board of Directors of assessee company approved a resolution on 18/12/2006 to convert foreign currency loan including interest accrued thereon up to 31-12-2006 aggregating to Rs.4,49,86,680/- into equity share capital. However, allotment of share application money was pending as on March, 2007. Subsequently in A. Y. 2008-09 (F. Y. 2007-08) as seen from the Note-3 of Schedule 1 of Balance Sheet that equity shares of said amount including accrued interest up to December 31,2006 were finally allotted to Yahoo Inc. USA, hence unsecured loan including interest of A.Y, 2007-08 (Schedule 3) has now converted into share application money in A.Y. 2008-09 (Schedule 2). Audit Scrutiny of assessment records and Profit & loss account revealed that assessee was regularly debiting interest expenditure on foreign currency loan to P & L account and in A.Y. 2007-08 assessee company debited Rs. 2,62,44,144/- on account of interest on foreign currency loan to P & L a/c (as on March 2007). Thus, share application money which was pending for allotment in A.Y. 2007-08 has been finally allotted and crystallized in A.Y. 2008-09. Therefore, interest up to December 31,2006 which was debited to P & L a/c is required to be disallowed as capital in nature in the year of crystallization (i.e. A.Y. 2008-09)

Hence, I have reason to believe that the income has escaped assessment. Notice u/s 148 is being issued separately."

5. In reply, during the assessment proceedings, the assessee stated that no interest expenses has been claimed during the financial year 2007-08. Hence, the assessment proceedings initiated for disallowing interest expense should be dropped. In this connection, the assessee also referred to Hon'ble Delhi High Court decision in the case of *Boble & Hewitt (I) (P.) Ltd.* [2008] 305 ITR 324 (Delhi), wherein the Hon'ble High Court has held as under:

since the assessee did not debit the amount to the Profit & Loss Account as an expenditure nor did the assessee claim any deduction in respect of the amount and considering that the assessee is following the mercantile system of accounting, the question of disallowing the deduction not claimed would not arise.

6. Furthermore, the assessee has made submissions about the allowability of the interest expenditure. The submissions of the assessee in this regard as reproduced by the

A.O. reads as under:

2.1 No interest expense has been claimed during FY 2007-08 and hence, reassessment proceedings initiated for disallowing interest expense should be dropped:

2.1.1 As it is evident from the facts stated above no interest expenditure was claimed as tax deductible expenditure in FY 2007-08, and interest expenditure was claimed in the previous year i.e. FY 2006-07. Therefore, considering the fact that no claim of tax deductible expenditure was made in the current FY i.e. 2007-08, no question of making a disallowance of the said expenditure arises.

2.1.2 Separately, the liability of interest payment on ECB became due/ got crystallized in FY 2006-07 i.e. AY 2007-08 and not in the captioned AY as per the terms of the ECB agreement. Also, the Assessee Company withheld applicable taxes at the appropriate rates and deposited the same in FY 2006-07 as per the applicable withholding tax provisions. Therefore, the basis of disallowance of interest expenditure of assuming that the interest liability was crystallised in the FY relating to the captioned AY 2008-09 is factually misplaced and incorrect.

2.1.3 Further, the assessee company submits that, it has been consistently following mercantile system of accounting for all the past and future years, and therefore, considering the fact that, the Assessee Company did not debit any interest expenditure amount to its profit & loss account for FY 2007-08 nor it claimed any tax deduction of any interest expenditure in the current FY, the question of disallowing any interest expense does not arise.

2.1.4 In this context, the Assessee Company relies on the Delhi High Court ruling in the case of Noble & Hewitt (I) (P.) Ltd wherein, the High court has held as under:

*"since the assessee did not debit the amount to the Profit & Loss Account as an expenditure nor did the assessee claim any deduction in respect of the amount and considering that the assessee is following the mercantile system of accounting, the question of disallowing the deduction not claimed would not arise."*

2.1.5 The Assessee Company further submits that, the ECB principal and the interest amount for the period April 2006 to December 2006 was converted in to Share Application Money in the earlier FY 2006-07. Accordingly, even the deemed payment of interest on ECB was made in the earlier FY 2006-07.

2.1.6 Considering the above facts and related submission, your goodself would appreciate that, the very basis of conducting the reassessment for captioned AY is factually misplaced since, the ECB interest was accrued and also paid in FY 2006-

07 and not in FY .relevant to the captioned AY and therefore, request your goodself to drop the reassessment proceedings.

2.2 Without prejudice to the above, the Assesses Company submits that, interest accrued on ECB till the date of conversion in to equity is a revenue expenditure and therefore qualifies as a deductible expenditure under the provision of the Act:

2.2.1 As your goodself is aware, the ECB was obtained for general corporate purpose and hence was utilized by the Assesses Company for meeting its working capital requirements. Therefore, the interest on such ECB qualifies as tax deductible revenue expenditure under the provisions of the Act. Further, since ECB is a pure debt instrument, interest on such debt instrument is allowable business expenditure. There was no option of conversion of ECB in to equity, offered at the time of issue of ECB. It was only due to Assessee Company's financial and commercial consideration that, the Assessee Company decided to convert the ECB in to equity. Therefore, the Assessee Company submits that, interest on ECB up the date of conversion for the period April 2006 to December 2006 is a pure revenue expenditure deductible under the provisions of the Act.

2.2.2 The Assessee Company further relies on the Delhi Tribunal decision in case of UAG Builders (PJ Lid [2012] 25 taxmann.com 205 (Delhi), wherein, the Tribunal confirming the observation of the Commissioner of Income tax (Appeals) has held that, debentures till the date of conversion in to equity are debt and gnyjnterest paid on such debentures till, date of conversion is an allowable normal business expenditure. The relevant extract of the judgment is as under:

*"Commissioner of Income Tax (A) rightly observed that debentures, whether fully or partly or optionally convertible, are nothing but debt till the date of conversion and any interest paid ort these debentures is allowable as normal business expenditure. The only uncertainty in the optionally convertible debentures issued by the assessee is whether the debenture holder will go for conversion into shares or will continue to hold them as debentures. Ld. Commissioner of Income Tax (A) rightly held that this uncertainty in no way impacts the assessee company's liability to pay interest till the date of conversion.*

Accordingly, since the ECB till the date of conversion in to equity is a debt, the interest paid on such loan is allowable business expenditure.

2.3 Your goodself had specifically raised an argument in the order, on whether the Assessee Company has complied with the provision of TDS on interest (i.e. whether withholding done). Accordingly, the Assessee Company hereby humbly submits before your goodself that, it has duly withheld and deposited the withholding taxes on the interest debited to the profit & loss account. The details of such withholding taxes is enclosed as Annexure 3 to this letter along with the challan details which matches the online TDS records as per the NSDL site.

7. However, the A.O. was not satisfied. He *inter alia* observed that there was no occasion to disallow the interest in assessment year 2006-07 relating to the assessment year 2007-08 since the conversion has not taken place. Hence, the A.O. made the impugned disallowance. The order of the A.O. in this regard may be gainfully referred as under:

The reply of the assessee has been considered carefully, however the same is not found satisfactory and cannot be accepted. Since the allotment of share application money was pending till the March, 2007. The equity were allotted including accrued interest up to December 31,2006 were allotted to Yahoo Inc, USA, therefore, unsecured loan including interest of A.Y. 2007-08 has been converted into share application money in A.Y. 2008-09. The assessee was regularly debiting interest expenditure on foreign currency loan to P & L account and in A.Y. 2007-08 assessee company debited Rs. 2,62,44,1447 on account of interest on foreign currency loan to P & L a/c (as on March 2007). Thus, share application money which was pending for allotment in A.Y. 2007-08 has been finally allotted in A.Y. 2008-09. Therefore, interest up to December 31,2006 which was debited to P & L a/c is amounting to Rs.2,62,44,144/- is disallowed as capital in nature and added to the income of the assessee. There was no occasion to disallow the interest in A.Y. 2006-07 relates to A.Y. 2007-08, since the conversion has not taken place, The share application money pending allotment has been issued & allotted shares in A.Y. 2007-08 only, therefore, interest is disallowed since it being crystallized in the A.Y. 2008-09. Since the assessee has furnished inaccurate particulars of its income.

8. Against this order, the assessee is in appeal before the Id. CIT(A) challenging both the validity of reopening and merits of the addition.

9. The Id. CIT(A) did not adjudicated upon the validity of reopening. However, as regards the merits, he held that interest cannot be treated as capital expenditure and deleted the addition. The Id. CIT(A) in this regard held as under:

4. As regards ground No. 1, it was noted that vide resolution dated 18/12/2006, the assessee company converted the foreign currency loan including interest there upon into equity share capital. The allotment of share application

money were as on March 2007 and were subsequently allotted in AY.2008-09. However, the interest upto the December 31/02/2006 on the foreign currency loan debited in the profit and loss account in AY.2007-08 was disallowed by the AO as capital expenses in nature. The detailed submission of the appellant is reproduced as above.

4.1 The appellant has contended that the interest accrued upto 31/12/006 was on the loan amount and was duly claimed in A.Y 2007-08 as observed by the AO also in the reasons for reopening. In this case, therefore, it is the admitted position that till 31/12/2006, it was the ECB loan on which interest was payable/claimed. Thus till date the amount is shown as loan, the interest payable upon the loan amount is of revenue nature. The appellant has converted the outstanding loan and interest accrued thereupon upto 31/12/2006 into shares and it is not the case of the AO that the expense in question is incurred due to conversion of loan into shares or in any way pertain to the shares allotted. Therefore in my considered opinion, such interest cannot be treated as capital expenditure and the addition made by the AO is therefore deleted.

10. Against the above order, the Revenue is in appeal upon the merits of the issue and the assessee has filed cross objection on the validity of the reopening.

11. We have heard both the counsel and perused the records. In this regard, we may gainfully refer to the provisions of section 147 of the Act which reads as under:

Income escaping assessment.

147. If the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of sections 148 to 153, assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section, or recompute the loss or the depreciation allowance or any other allowance, as the case may be, for the assessment year concerned (hereafter in this section and in sections 148 to 153 referred to as the relevant assessment year) :

12. From the above provision of law, it can be construed that the reopening is permissible if there is escapement of income from assessment in that particular year. It will be totally naive to hold that the reopening in a particular assessment year can be

done for escapement of income which have not at all relate to that particular assessment year.

13. In this case, we note that as emanating from the reasons recorded, the assessment has been reopened to make the disallowance of interest which has not at all been incurred in the impugned assessment year. With the assistance of the Id. Counsel of the assessee, we have gone through the profit and loss account of the assessee company for the past year as submitted in paper book. It is clear that the amount sought to be disallowed was debited in the financial year 2006-07 which is not at all relevant for the assessment year 2008-09 in which assessment is sought to be done. No interest whatsoever has been debited in the assessment year 2008-09. Hence, in our considered opinion, there is no question at all of disallowing the interest as capital expenditure which has not at all been debited in the impugned assessment year. Since, there is no debit of interest in the current assessment year, there is no question whatsoever of disallowing the same on the ground that there has been escapement of income.

14. To reiterate, when the amount in question has not been debited in the profit and loss account as expenditure, nor the assessee has claimed any deduction and the assessee is following mercantile system of accounting, there is no question of disallowing the deduction which has not at all been claimed by the assessee. In this connection, the Hon'ble Delhi High Court decision in the case of *Boble & Hewitt (I) (P.) Ltd* (supra) applies on all fours to the facts of this case. Hence, the reason recorded for reopening is

that there is escapement of income is totally unsustainable at the threshold. Hence, the validity of reopening in this case is held to be subject to rescission.

15. As regards the merits of the case, on similar analogy, since the impugned expenditure was not incurred during the current year, there is no question of disallowing the same in the current assessment year. We note that the Id. CIT(A) has allowed the appeal on merits on a different reasoning that expenditure involved though relating to earlier year was revenue in nature and cannot be treated as capital in nature. Be as it may, as we have already given a finding hereinabove, that there was no question of making a disallowance of interest expenditure for whatever reason as the said expenditure was not at all debited during the year, the assessee succeeds on both the counts of lack of validity of reopening as well as merits of addition. In this regard, we are not inclined to accede to Id. DR's request that a direction should be given for making the addition in earlier assessment year. We are of the opinion that in doing so, we shall be exceeding our jurisdiction. The ITAT is not mandated to exercise revisionary powers which are vested with Id. CIT u s. 263 of the Act to cure fatal errors and omission on the part of the Revenue authorities.

13. In the result, the appeal by the Revenue stands dismissed and the cross objection by the assessee stands allowed.

*Order pronounced in the open court on 06.09.2018*

Sd/-  
(Pawan Singh)  
Judicial Member

Sd/-  
(Shamim Yahya)  
Accountant Member

Mumbai; Dated : 06.09.2018

Roshani, Sr. PS

**Copy of the Order forwarded to :**

1. The Appellant
2. The Respondent
3. The CIT(A)
4. CIT - concerned
5. DR, ITAT, Mumbai
6. Guard File

BY ORDER,

(Dy./Asstt Registrar)  
ITAT, Mumbai

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