

TAX FLASH NEWS

24 December 2020

Tax is not required to be deducted if annual interest on CCD is not accrued and claimed during the year

Recently, the Bangalore Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Coffeeday Enterprises Ltd¹ (the taxpayer) dealt with the issue of deduction of tax at source on the interest on Compulsorily Convertible Debentures (CCDs) which is not accrued and claimed during the year. The Tribunal held that the tax is not required to be deducted at source under Section 195 of the Income-tax Act, 1962 (the Act) if annual interest on CCDs is not accrued and claimed during the year. The taxpayer had not paid any interest because eventually it was waived off.

The Tribunal also observed that when no time limit is prescribed under the statute for initiating and completion of a proceeding, the powers should be exercised within the reasonable time. The instant case pertains to financial year 2010-11 and notice for initiating TDS proceedings was issued on 19 March 2018. However, TDS order under Section 201(1)/(1A) was finally passed on 31 March 2018, which was 7 years from the end of the financial year. The Tribunal observed that TDS order under Section 201(1)/(1A) was not passed by the Assessing Officer (AO) within a reasonable time and therefore, it was barred by limitation.

Facts of the case

During the Assessment Year (AY) 2011-12, the taxpayer entered into a subscription agreement with a Cyprus based company. As per the provisions of the agreement, the Cyprus based company had invested in the form of CCDs in the taxpayer company. The Cyprus based company was entitled to receive a coupon

on an annual basis at the rate of 7 per cent per annum for a period of 2 years from the date of issue of CCDs and 3 months LIBOR plus 600 basis points per annum for a period of 3 years from the completion of the 2 year period. Further, the agreement mentioned that the coupon will be payable on 30 April of each year. For Financial Year (FY) 2010-11, initially it was agreed that, interest would be paid on 30 April 2011, however with the amendment to the agreement, which was entered into on 1 July 2011, the interest payment was to be made on 30 April 2013 and hence the interest for FY 2010-11 and FY 2011-12 were waived off.

The AO observed that it shall be incumbent on the taxpayer to pay the interest and deduct the applicable taxes or in the case of non-payment, the same shall be treated as liability in the balance sheet. Both these treatment for the transaction of interest was not done. In order to avoid the deduction of withholding taxes, the taxpayer claimed that interest was waived through a waiver agreement. However, no waiver agreement was submitted to the Cyprus based company. Therefore, the taxpayer was liable to deduct tax as the income was accrued in the hands of Cyprus based company. Consequently, TDS order under Section 201(1)/(1A) was passed for default in non-deduction of tax for AY 2011-12.

With respect to the period of limitation, the Commissioner of Income-tax (Appeals) [CIT(A)] observed that if no time period is prescribed under the Act, then it can only be exercised within a reasonable time and not beyond that. In the present case, a search action under Section 132 was initiated on 21 September 2017. The AO issued notice for AY 2011-12 under Section 201(1)/(1A) on 19 March 2018 i.e. within six months from the date of the search. Therefore, the CIT(A) rejected the contention of the taxpayer that the present proceedings are barred by limitation and dismissed the appeal of the taxpayer on this issue.

¹ DCIT v. Coffeeday Enterprises Ltd (ITA No.2931/Bang/2018 & C.O. No. 42/Bang/2019) – Taxsutra.com

Tribunal's decision

Withholding of tax where annual interest on CCDs is not accrued and claimed during the year

The Tribunal observed that the payment/credit was not made till 31 March 2010 and also in terms of the agreement, interest was due on 30 April 2011, i.e., in FY 2011-12 relevant to AY 2012-13 and not in the year in question. On perusal of the financials of the taxpayer it was observed that the taxpayer had not claimed interest expenditure pertaining to the transaction with Cyprus based entity.

Further, in view of the waiver of the interest and the benefit having accrued to the taxpayer, the taxpayer voluntarily agreed to offer the benefit accrued (i.e. 7 per cent of the amount of investment) which implied that the amount was not treated as chargeable to tax in the hands of the non-resident entity.

Section 195 specifies that taxes will have to be deducted either at the time of credit of such income in the account of the payee or at the time of payment thereof in cash or any other mode. As per the terms of agreement, the interest for the FY 2010-11 was required to be credited on 30 April 2011. Thus, during the AY in question, there was no interest required to be credited also. There was no expenditure accrued or claimed during the previous year and hence, the provisions of Section 195 were not applicable.

The Tribunal relied on various decisions² to support its case. Reliance was also placed on the decision of the Mumbai Tribunal in the case of National Organic Chemical Industry³ where it was held that the term 'paid' used in a tax treaty is to be interpreted as intended to be taxed on 'paid' basis and not on accrual basis. On the same analogy, since the transaction which was a subject matter of the present appeal was covered by India-Cyprus tax treaty, the issue of deduction of tax at source on accrual basis does not arise for the reason that interest was not paid and not provided in the books also.

Limitation period for TDS order

The question whether the TDS order passed for the AY 2011-12, was barred by limitation was decided against the taxpayer by the CIT(A), for the reason that the time limit period of 6 years provided under Section 201(3) is applicable to a person resident in India. However, in the taxpayer's case the deductee is not a resident and therefore the time limit period of 6 years prescribed under Section 201(3) will not apply to the present case.

The Special Bench of the Tribunal in the case of Mahindra & Mahindra Ltd.⁴ had held that order passed under Section 201(1) is akin to an order of assessment and the reasonable time limit for passing an order under Section 201(1)/(1A) would be the same as the time limit prescribed for initiating and completion of reassessment under Section 147. The Special Bench's order was confirmed by the Bombay High Court in the case of Mahindra & Mahindra Ltd.⁵ The Special Bench's order was considering payments made to non-residents. In the present case also, the payees are non-resident and that was the reason for the CIT(A) to hold that the time limit mentioned under Section 201(3) does not have application to this case. When no time limit is prescribed under the statute for initiating and completion of a proceedings, the powers should be exercised within the reasonable time. The Kerala High Court in the case of Iswara Bhat⁶ held that the Commissioner has to pass an order within a reasonable time and what is a reasonable time limit depends on the facts of that particular case.

In the instant case, the financial year concerned is 2010-11 and notice for initiating proceedings under Section 201(1)/(1A) was issued on 19 March 2018. However, TDS orders under Section 201(1)/(1A) was finally passed on 31 March 2018, which was 7 years from the end of the financial year. Therefore, it cannot be stated that the order under Section 201(1)/(1A) was passed within a reasonable time, going by the dictum laid down by the judicial pronouncement mentioned and the prescription of limitation mentioned under Section 201(3) and (4) of the Act. Similar view was taken by the Cochin Tribunal⁷ wherein the present Accountant Member was the co-author of the said order. Accordingly, it was held that the TDS order passed under Section 201(1)/(1A) was barred by the limitation in the facts and circumstances of the case.

Our comments

The issue with respect to deduction of tax on the interest on CCDs has been a subject matter of debate. The Karnataka High Court in the case of Karnataka Power Transmission Corporation Ltd. held that when interest has not been paid to the payee and the provision of the same has been reversed in the books of accounts, there would be no liability to deduct tax as no income has accrued in the hands of the payee.

⁴ Mahindra & Mahindra Ltd. v. DCIT [2010] 122 ITD 216 (Mum)

⁵ DIT v. Mahindra & Mahindra Ltd. [2014] 48 taxmann.com 150 (Bom)

⁶ Iswara Bhat v. Commissioner of Agricultural Income-tax [1993] 200 ITR 238 (Ker)

⁷ U.S. Technology Resources (P) Ltd. (ITA No.122/Coch/2017, dated 10 April 2018)

² Karnataka Power Transmission Corporation Ltd. v. DCIT [2016] 383 ITR 59 (Kar), National Organic Chemical Industry v. DCIT [2006] 5 SOT 317 (Mum), CIT v. Kalyani Steels Ltd [2018] 254 Taxman 350 (Kar)

³ National Organic Chemical Industry v. DCIT [2006] 5 SOT 317 (Mum)

In a tax treaty scenario, the Mumbai Tribunal in the case of National Organic Chemical Industry⁸ held that the term 'paid' used in a tax treaty is to be interpreted as intended to be taxed on 'paid' basis and not on accrual basis.

The Tribunal in the present case has held that the tax was not required to be deducted at source under Section 195 if annual interest on CCDs was not accrued and claimed during the year. The taxpayer had not paid any interest because eventually it was waived off. Since no interest was paid or claimed as expenditure, the provisions of Section 195 cannot apply.



⁸ National Organic Chemical Industry v. DCIT [2006] 5 SOT 317 (Mum)

KPMG in India addresses:

Ahmedabad

Commerce House V, 9th Floor,
902, Near Vodafone House, Corporate
Road,
Prahlad Nagar,
Ahmedabad – 380 051.
Tel: +91 79 4040 2200

Bengaluru

Embassy Golf Links Business Park,
Pebble Beach, 'B' Block,
1st & 2nd Floor,
Off Intermediate Ring Road, Bengaluru –
560071
Tel: +91 80 6833 5000

Chandigarh

SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Chennai

KRM Towers, Ground Floor,
1, 2 & 3 Floor, Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Gurugram

Building No.10, 8th Floor,
DLF Cyber City, Phase II,
Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

Hyderabad

Salarpuria Knowledge City,
6th Floor, Unit 3, Phase III,
Sy No. 83/1, Plot No 2, Serilingampally
Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Jaipur

Regus Radiant Centre Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road,
Jaipur – 302 018.
Tel: +91 141 - 7103224

Kochi

Syama Business Centre,
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

Kolkata

Unit No. 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai

1st Floor, Lodha Excelus,
Apollo Mills,
N. M. Joshi Marg,
Mahalaxmi,
Mumbai – 400 011.
Tel: +91 22 3989 6000

Noida

Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201 305.
Tel: +91 0120 386 8000

Pune

9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex,
Mundhwa Road, Ghorpadi,
Pune – 411 001.
Tel: +91 20 6747 7000

Vadodara

Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada

Door No. 54-15-18E,
Sai Odyssey,
Gurunanak Nagar Road, NH 5,
Opp. Executive Club, Vijayawada,
Krishna District,
Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000

home.kpmg/in



home.kpmg/in/socialmedia



The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

KPMG Assurance and Consulting Services LLP, Lodha Excelus, Apollo Mills Compound, NM Joshi Marg, Mahalaxmi, Mumbai - 400 011
Phone: +91 22 3989 6000, Fax: +91 22 3983 6000

© 2020 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

KPMG (Registered) (a partnership firm with Registration No. BA- 62445) converted into KPMG Assurance and Consulting Services LLP (a Limited Liability partnership firm) with LLP Registration No. AAT-0367 with effect from July 23, 2020.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

This document is meant for e-communication only.