Conversion of loan into equity as part restructuring is a genuine transaction and it does not violate provisions of Section 269T of the Income-tax Act, and hence levy of penalty is to be deleted

Background

Recently, Kolkata Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Arkit Vincom Pvt. Ltd. (the taxpayer) held that the transaction with respect to the conversion of loan into equity carried out by the taxpayer through book entries without any physical outflow of funds cannot be considered to be in violation of provisions of Section 269T of the Income-tax Act, 1961 (the Act). It is usual business practice and is part of routine corporate debt restructuring exercise carried out by various banks and financial institutions, to give leeway to the borrowers/defaulters, to convert their existing loans advanced to the said borrowers into equity capital. This is done as a normal routine business practice in the market as part of business revival plans carried out by the lenders. Therefore, levy of penalty under Section 271E of the Act for violation of provisions of Section 269T of the Act is to be deleted.

The Tribunal observed that it was a conscious business decision taken by the taxpayer to use the amounts raised through share capital for investing in co-ownership property for the purpose of its business. The businessman (i.e., the taxpayer) cannot be compelled by the revenue to conduct its business as per the whims and fancies of the revenue. It is well settled that the businessman knows his interest best and the point of commercial expediency had to be viewed from the view point of the taxpayer and not from the view point of the revenue.

Facts of the case

- The taxpayer is engaged in the business of trading of iron and steel and had filed its return of income for the Assessment Year 2008-09 declaring a loss. The taxpayer had existing loans in its books of accounts. This loan was converted into equity by way of book entry without any physical outflow of funds from the side of the taxpayer, i.e., the taxpayer had squared off the loan by way of allotment of equity shares with a premium.

- The taxpayer has also raised fresh funds in the form of share capital and also an advance against property. These funds were utilised to acquire co-ownership of property, and the same has been mortgaged to the bank for the benefit of the company.

- The Assessing Officer (AO) held that the loan was repaid by the taxpayer otherwise than by way of account payee cheque or draft and initiated penalty proceedings under Section 271E of the Act for violation of provisions of Section 269T of the Act. The AO observed that the taxpayer had not brought any material on record to prove that it was prevented by any reasonable cause for failure to observe the provision contained under Section 269T of the Act and therefore would not get benefit under Section 273B of the Act.

- The taxpayer claimed that term ‘repayment’ mentioned in Section 269T of the Act refers only to repayment in the form of money and does not apply to repayment in kind or through book adjustments.

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1 Arkit Vincom Pvt Ltd v. ACIT (ITA No. 2397/Kol/2016) – Taxsutra.com
2 No branch of a banking company or a co-operative bank and no other company or co-operative society and no firm or other person shall repay any loan otherwise than by way of an account payee cheque or account payee draft
The Commissioner of Income-tax (Appeals) [CIT(A)] held that the transaction of conversion of loan into equity is not genuine and upheld the levy of penalty by reiterating the order of the AO.

**Tribunal’s decision**

- The taxpayer had duly placed all the relevant data before the AO. Hence the bonafide intention of the taxpayer in placing all facts on record cannot be doubted at all in the instant case. Increase in share capital has been examined by the AO, and after this examination, the AO had not proceeded to make any addition towards the share capital. Hence, it could be concluded that the transactions of receipt of share capital and share premium have been accepted as bonafide and genuine by the AO in the assessment.

- The transaction could not be treated as non-genuine and not bonafide for the purpose of levying penalty under Section 271E of the Act alone. Even assuming that the receipt of share capital with premium is not genuine, still, the tax department had not taken any action on the taxpayer to treat the same as unexplained cash credit under Section 68 of the Act.

- The CIT(A) while adjudicating the penalty appeal, having come to a conclusion that the receipt of share capital with premium by the taxpayer was not genuine and bonafide transaction, ought to have triggered the Administrative Commissioner of Income Tax to initiate proceedings under Section 263 of the Act, which was not done in the instant case. There are adequate precautions provided in the statute to take care of situations like this i.e. by reopening the assessment under Section 147 of the Act by the AO or by having recourse to revisionary proceedings under Section 263 of the Act by the CIT.

- The conversion of loan into equity through book entries without any physical outflow of funds is usual business practice and is part of routine corporate debt restructuring exercise. The said transaction carried out by various banks and financial institutions, to give leeway to the borrowers/defaulters, to convert their existing loans advanced to the said borrowers into equity capital. This is done as a normal routine business practice in the market as part of business revival plans carried out by the lenders and Board of Industrial & Financial Reconstruction (BIFR) having jurisdiction over sick industrial companies registered under Sick Industrial Companies Provisions Act, 1985.

- In respect of External Commercial Borrowings (ECB) availed by an Indian company from a parent company abroad, it is quite usual to convert the said loan into equity as part of restructuring exercise and increase in a stake of the parent company in the Indian company. Even in such a scenario, the ECB loan gets converted into equity. It cannot be said that the same is in violation of provisions of Section 269T of the Act.

- The genuinity of the said transactions cannot be questioned by the CIT(A). The said transaction cannot be considered to be in violation of provisions of Section 269T of the Act. Accordingly, it has been held that the taxpayer had properly explained the entire gamut of transactions together with its end use, i.e., for investment in co-ownership property.

- It was a conscious business decision taken by the taxpayer to use the amounts raised through share capital for investing in co-ownership property for the purpose of its business, and the businessman (i.e., the taxpayer) cannot be compelled by the revenue to conduct its business as per the whims and fancies of the revenue. It is well settled that the businessman knows his interest best and the point of commercial expediency had to be viewed from the view point of the taxpayer and not from the view point of the revenue.

- Hence, the observation of the CIT(A) that the taxpayer could have utilised the amounts raised through share capital from other sources to repay the loan would only tantamount to stepping into the shoes of the businessman and the Tribunal held that the said observation is not warranted, more so in the penalty proceedings under Section 271E of the Act.

- The business compulsions of the taxpayer warranting such conversion of loan into equity cannot be brushed aside simply as a matter of doubt merely because the shares were issued at a premium. The remedy available to revenue in such scenario is provided elsewhere in the Act. These factors cannot contribute to confirmation of levy of penalty under Section 271E of the Act which is equal to the amount of loan repaid. Accordingly, it has been held that the levy of penalty under Section 271E of the Act is not justified and accordingly deleted.
Our comments

Accepting/repayment of loans other than account payee cheques/drafts (through journal entries) amounts to a violation of the provisions of Section 269SS and 269T of the Act. The penalty may be levied under Section 271D and Section 271E for contravention of these provisions. However, to cater to the needs of such exigencies, the legislature has enacted Section 273B which provides that no penalty under Section 271E shall be imposed for contravention of Section 269T if reasonable cause for such contravention is shown. The expression ‘reasonable cause’ in Section 273B for non-imposition of penalty under Section 271E have been construed depending upon the facts of each case.

The Bombay High Court in the case of Triumph International Finance (I) Ltd\(^3\) held that where loan/deposit has been repaid by merely debiting account through journal entries, it must be held that the taxpayer has contravened provisions of Section 269T of the Act. However, in the absence of any finding recorded in the assessment order or in the penalty order that the repayment of loan/deposit was not a bona fide transaction and was made with a view to evade tax, the cause shown by the taxpayer was a reasonable cause and, therefore, in view of Section 273B, no penalty under Section 271E could be imposed for contravening the provisions of Section 269T.

Similarly, the Mumbai Tribunal in the case of Lodha Builders Pvt Ltd\(^4\) held that though the taxpayer has violated the provisions of Section 269SS/269T of the Act in respect of journal entries, the taxpayer has shown reasonable cause and, therefore, the penalty imposed under Section 271D/E of the Act are not sustainable.

The Tribunal in the present case has held that conversion of loan into equity as part restructuring is a genuine transaction and it does not violate the provisions of Section 269T of the Act and hence levy of penalty is to be deleted.


\(^{4}\) Lodha Builders Pvt Ltd v. ACIT (ITA No. 476/M/2014, dated 27 June 2014
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