

TAX FLASH NEWS

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Deduction of interest payable is not allowed on conversion of such interest into a loan in view of specific provision under Section 43B of the Income-tax Act

Background

Recently, the Supreme Court in the case of Gujarat Cypromet Ltd.¹ (the taxpayer) held that in view of Section 43B of the Income-tax Act, 1961 (the Act), the taxpayer is not entitled to claim a deduction of interest which was payable during the year but converted into a loan.

Facts of the case

During the assessment year 2001-02, the taxpayer was liable to pay interest to a financial institution. The taxpayer converted such unpaid interest into a loan. However, the taxpayer claimed the interest deduction while computing business income. The Assessing Officer (AO) disallowed the deduction claimed by the taxpayer with regard to payment of interest. The Commissioner of Income-tax (Appeal) [CIT(A)] deleted the disallowance made by the AO. The Tribunal upheld the order of the CIT(A). The High Court dismissed the appeal filed by the tax department.

Tax department's contentions

The High Court had not adverted to the statutory provision of Explanation 3C to Section 43B which was introduced by the Finance Act, 2006 with effect from 1 April 1989, which re-stated what was earlier contained in the Circular² relied by the AO. Explanation 3C to Section 43B was added to take care of such a claim of payment of interest which was actually not paid and camouflaged by way of a loan or other type of financial advance.

Supreme Court's decision

The interest liability which was accrued during the relevant assessment year was not actually paid back by the taxpayer rather was sought to be adjusted in the further loan.

The provision of Section 43B covers a host of different situations. Explanation 3C inserted by the Finance Act, 2006 is squarely applicable in the facts of the present case. It appears that the attention of the High Court was not invited to Explanation 3C to Section 43B.

Therefore, the Supreme Court ruled that the AO had rightly disallowed the deduction as claimed by the taxpayer. The CIT(A), the Tribunal and the High Court had erred in reversing the said disallowance.

Our comments

There has been a considerable litigation with respect to the allowability of interest payable vis-à-vis conversion of such interest into a loan. The Supreme Court puts to rest the controversy and held that in view of Explanation 3C to Section 43B of the Act, the taxpayer is not entitled to claim an interest deduction on the conversion of such interest into a loan.

¹ CIT v. Gujarat Cypromet Ltd. (Civil Appeal No. 5347/2010) (SC) – Taxsutra.com

² Circular No. 528, dated 16 December 1988

Ahmedabad

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

Bengaluru

Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala,
Bengaluru – 560 071.
Tel: +91 80 3980 6000

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