

**IN THE HIGH COURT FOR THE STATE OF TELANGANA
AT HYDERABAD**

**MONDAY, THE TWENTY THIRD DAY OF DECEMBER
TWO THOUSAND AND TWENTY FOUR**

PRESENT

**THE HONOURABLE THE CHIEF JUSTICE ALOK ARADHE
AND**

THE HONOURABLE SRI JUSTICE J SREENIVAS RAO

INCOME TAX TRIBUNAL APPEAL NO: 239 OF 2008

Appeal under section 260A of the Income Tax Act., against the dated 20.04.2006 passed in I.T.A.No.532/Hyd/2004 for the Assessment year 1999-2000 on the file of the Income Tax Appellate Tribunal, Hyderabad Bench 'B', Hyderabad preferred against the Order dated 05.03.2004 Passed in ITA.No.265/CIT(A)-II/03-04 on the file of the Commissioner of Income Tax (Appeals)-II, Hyderabad Preferred against the Order dated: 29.08.2003 in PAN/GIR.No. AAACF5186B on the file of the Deputy Commissioner of India Tax Circle1(3), Hyderabad.

Between:

M/s. Frontier Information Tech Ltd., D-18, Vikrampuri, Meghana Plaza,
Secunderabad.

...APPELLANT

AND

The Deputy Commissioner of Income Tax, Circle - 1 (3) Hyderabad.

...RESPONDENT

Counsel for the Appellant: SRI. A.V.A SIVA KARTIKEYA

Counsel for the Respondent: SRI. J V PRASAD, SC FOR INCOME TAX

The Court delivered the following: JUDGMENT

**THE HON'BLE THE CHIEF JUSTICE ALOK ARADHE
AND
THE HON'BLE SRI JUSTICE J. SREENIVAS RAO**

ITTA No. 239 of 2008

JUDGMENT: (per the Hon'ble the Chief Justice Alok Aradhe)

Mr. A.V.A. Siva Kartikeya, learned counsel appears for the appellant/assessee.

Mr. J.V.Prasad, learned Senior Standing Counsel for Income-tax Department appears for the respondent/Revenue.

2. This appeal under Section 260A of the Income-tax Act, 1961 (for short the 'Act'), has been filed against order dated 20.04.2007, passed by the Income Tax Appellate Tribunal, Hyderabad Bench 'B', Hyderabad (for short 'the Tribunal'), in I.T.A.No.532/Hyd/2004.

3. The subject matter of the appeal pertains to the assessment year 1999-2000.

4. The appeal was admitted on the following substantial question of law:

"Whether on the facts ~~and~~ circumstances of the case, the Hon'ble Tribunal is right in disallowing the claim of interest

converted to equity in a sum of Rs.75,75,000/- on a proper interpretation of Section 43B of the Income Tax Act, 1961?"

5. Facts giving rise to filing of this appeal briefly stated are that the assessee is a company and is a developer of software. The assessee filed the return of income on 29.12.1999 declaring the loss of Rs.1,00,64,340/-. The return filed by the assessee was processed under Section 143(1)(a) of the Act. The assessee in the return of income during the financial year 1998-99 had converted the interest due of Rs.75,75,000/- to Andhra Pradesh Industrial Development Corporation Limited (for short 'APIDC') into equity shares by issuing 5,05,000 shares of Rs.10/- each totaling to a sum of Rs.50,50,000/-. Interest of Rs.39,94,429/- had accrued to the assessee and was due to Andhra Pradesh State Financial Corporation (for short 'APSFC'). The case of the assessee was selected for scrutiny and notices under Sections 143(2) and 142(1) of the Act were issued. The assessee was asked to file objections, if any, to disallowance of unpaid interest of Rs.75.75 lakhs and Rs.39.94 lakhs under Section 43B of the Act.

6. The assessee thereupon filed objections in which it was stated that the assessee had paid outstanding interest and had received back the same amount as additional loan from financial institutions. The assessee also stated that since constructive payment of interest outstanding was made on or before the due date, no disallowance under Section 43B of the Act is called for. The Assessing Officer by an order dated 29.08.2003 *inter alia* held that actual payment of the amount is *sine qua non* for allowing deduction under Section 43B of the Act. It was further held that conversion of outstanding interest liability into loan i.e., funding interest or into equity does not amount to actual payment. Accordingly, a sum of Rs.75,75,000/- and Rs.39,94,429/- was disallowed under Section 43B of the Act on the ground that the same was not actually paid.

7. The assessee thereupon filed an appeal before the Commissioner of Income-tax (Appeals). The Commissioner of Income-tax (Appeals) by an order dated 05.03.2004 *inter alia* held that the interest was not actually paid by the assessee to APIDC and APSFC and therefore, the Assessing Officer is justified in not

allowing the amount in question under Section 43B of the Act. Accordingly, the appeal was dismissed.

8. The assessee thereupon filed an appeal before the Tribunal. The Tribunal by an order dated 20.04.2007 partly allowed the appeal preferred by the assessee. In the aforesaid factual background, this appeal has been filed by the assessee.

9. Learned counsel for the assessee has submitted that constructive payment amounts to actual payment within the meaning of Section 43B of the Act. In support of aforesaid submission, reliance has been placed on the decisions of the Supreme Court, Delhi and Gujarat High Courts in **M.M. Aqua Technologies Limited v. Commissioner of Income-tax, Delhi-III¹**; **Commissioner of Income-tax-V v. Rathi Graphics Technologies Limited²** and **Commissioner of Income-tax v. Core Emballage Ltd³** respectively.

10. On the other hand, learned Senior Standing Counsel for the Revenue has submitted that admittedly, the amount in question has

¹ (2021) 436 ITR 582 (SC)

² (2015) 378 ITR 107 (Delhi)

³ (2022) 443 ITR 157 (Gujarat)

not actually been paid and therefore, the authorities under the Act are justified in denying the benefit under Section 43B of the Act to the assessee. It is submitted that from a plain and liberal interpretation of Section 43B of the Act, it is evident that in order to attract the applicability of the aforesaid provision, actual payment should be made which admittedly has not been paid in the instant case. It is therefore contended that with regard to disallowance of claim, the Tribunal has properly interpreted Section 43B of the Act and the orders passed by the authorities under the Act, do not call for any interference.

11. We have considered the rival submissions made by the learned counsel for the parties and perused the record.

12. In the instant case, the assessee had converted the liability to pay interest by issuing equity shares in favour of APIDC. The issue which arises for consideration in this appeal is whether the same would amount to "actual payment" within the meaning of Section 43B of the Act. The authorities under the Act *inter alia* found that the interest payable by the assessee was converted into equity shares. However, the same was constructive payment and

not an actual payment and therefore, the claim of the assessee for deduction under Section 43B of the Act was negated.

13. Section 43B of the Act has been inserted by the Finance Act, 1983 with effect from 01.04.1984. Clause (d) to Section 43B was inserted by the Finance Act, 1988 with effect from 01.04.1989. Explanation 3C and Explanation 3D were inserted by the Finance Act, 2006 with effect from 01.04.1989 and 01.04.1997 respectively. The relevant extract of Section 43B reads as under:

“43B. Notwithstanding anything contained in any other provision of this Act, a deduction otherwise allowable under this Act in respect of –

... ..

(d) any sum payable by the assessee as interest on any loan or borrowing from any public financial institution or a State financial corporation or a State industrial investment corporation, in accordance with the terms and conditions of the agreement governing such loan or borrowing, or

... ..

(e) any sum payable by the assessee as interest on any loan or advances from a scheduled bank or a co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank in accordance with the terms and

conditions of the agreement governing such loan or advances, or

... ..

Provided that nothing contained in this Section except the provisions of clause (h) shall apply in relation to any sum which is actually paid by the assessee on or before the due date applicable in his case for furnishing the return of income under sub-section (1) of Section 139 in respect of the previous year in which the liability to pay such sum was incurred as aforesaid and the evidence of such payment is furnished by the assessee along with such return.

... ..

Explanation 3C. For the removal of doubts, it is hereby declared that a deduction of any sum, being interest payable under clause (d) of this section, shall be allowed if such interest has been actually paid and any interest referred to in that clause which has been converted into a loan or borrowing or debenture or any other instrument by which the liability to pay is deferred to a future date shall not be deemed to have been actually paid.

Explanation 3D. For the removal of doubts, it is hereby declared that a deduction of any sum, being interest payable under clause (e) of this section, shall be allowed if such interest has been actually paid and any interest referred to in that clause which has been converted into a loan or advance or debenture or any other instrument by which the liability to pay is deferred to a future date shall not be deemed to have been actually paid.”

14. The scope and ambit of Section 43B of the Act was considered by the Supreme Court in **M.M.Aqua Technologies Limited** (supra). The assessee in the aforesaid decision claimed deduction under Section 43B of the Act on the issue of debentures in lieu of interest accrued and payable to financial institutions. The Supreme Court in paragraphs 17 to 21 and 23 and 24 held as under:

“17. Section 43-B was originally inserted by the Finance Act, 1983 w.e.f. 1-4-1984. The scope and effect of the newly inserted provision, at that point, was explained by the Central Board of Direct Taxes (“the Board”) in Circular No. 372/1983 dated 8-12-1983 as follows:

“35.2. Several cases have come to notice where taxpayers do not discharge their statutory liability such as in respect of excise duty, employer's contribution to provident fund, Employees State Insurance Scheme, etc., for long periods of time, extending sometimes to several years. For the purposes of their income tax assessments, they claim the liability as deduction on the ground that they maintain accounts on mercantile or accrual basis. On the other hand, they dispute the liability and do not discharge the same. For some reasons or the other, undisputed liabilities also are not paid.

35.3. To curb this practice, the Finance Act has inserted a new Section 43-B to provide that deduction for any sum payable by the assessee by way of tax or duty

under any law for the time being in force or any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees shall irrespective of the previous year in which the liability to pay such sum was incurred, be allowed only in computing the income of that previous year in which such sum is actually paid by the assessee.

35.4. The section also contains an *Explanation* for the removal of doubts. The *Explanation* provides that where a deduction in respect of any sum aforesaid is allowed in computing the income of any previous year, being a previous year relevant to Assessment Year 1983-84, or any earlier assessment year, in which the liability to pay such sum was incurred by the assessee, the assessee shall not be entitled to any deduction under Section 43-B in respect of such sum on the ground that the sum has been actually paid by him in that year. In other words, an assessee who has already been allowed deduction of a liability on account of the tax or duty or in respect of any sum payable as contribution to any fund for Assessment Year 1983-84, or any earlier year in which the liability to pay was incurred, cannot, in respect of that liability, be allowed a deduction in Assessment Year 1984-85, or any subsequent year on the ground that he has actually made a payment towards such liability in that year.”

18. As has been pointed out hereinabove, the Finance Act, 2006 inserted Explanation 3-C w.r.e.f. 1-4-1989. The scope and effect of this provision was

explained by the Board in Circular No. 14/2006 dated 23-12-2006, as follows:

“16.2. It has come to notice that certain assesseees were claiming deduction under Section 43-B on account of conversion of interest payable on an existing loan into a fresh loan on the ground that such conversion was a constructive discharge of interest liability and, therefore, amounted to actual payment. Claim of deduction against conversion of interest into a fresh loan is a case of misuse of the provisions of Section 43-B. A new Explanation 3-C has, therefore, been inserted to clarify that if any sum payable by the assessee as interest on any loan or borrowing, referred to in clause (d) of Section 43-B, is converted into a loan or borrowing, the interest so converted, shall not be deemed to be actual payment.

16.3. This amendment takes effect retrospectively from 1-4-1989 i.e. the date from which clause (d) was inserted in Section 43-B and applies in relation to Assessment Year 1989-90 and subsequent years.”

19. The object of Section 43-B, as originally enacted, is to allow certain deductions only on actual payment. This is made clear by the non obstante clause contained in the beginning of the provision, coupled with the deduction being allowed irrespective of the previous years in which the liability to pay such sum was incurred by the assessee according to the method of accounting regularly employed by it. In short, a mercantile system of accounting cannot be looked at when a deduction is claimed under this section, making it clear that incurring of liability cannot allow for a deduction, but only “actual payment”, as contrasted with

incurring of a liability, can allow for a deduction. Interestingly, the "sum payable" referred to in Section 43-B(d), with which we are concerned, does not refer to the mode of payment, unlike proviso 2 to the said section, which was omitted by the Finance Act, 2003 w.e.f. 1-4-2004. The said proviso reads as follows:

"Provided further that no deduction shall, in respect of any sum referred to in clause (b), be allowed unless such sum has actually been paid in cash or by issue of a cheque or draft or by any other mode on or before the due date as defined in the Explanation below clause (v-a) of sub-section (1) of Section 36, and where such payment has been made otherwise than in cash, the sum has been realised within fifteen days from the due date."

20. This being the case, it is important to advert to the facts found in the present case. Both CIT and ITAT found, as a matter of fact, that as per a rehabilitation plan agreed to between the lender and the borrower, debentures were accepted by the financial institutions *in discharge of* the debt on account of outstanding interest. This is also clear from the expression "in lieu of" used in the judgment of the learned CIT. That this is so is clear not only from the accounts produced by the assessee, but equally clear from the fact that in the assessment of ICICI Bank, for the assessment year in question, the accounts of the bank reflect the amount received by way of debentures as its business income. This being the fact situation in the present case, it is clear that interest was "actually paid" by means of issuance of debentures, which extinguished the liability to pay interest.

21. Explanation 3-C, which was introduced for the “removal of doubts”, only made it clear that interest that remained unpaid and has been converted into a loan or borrowing shall not be deemed to have been actually paid. As has been seen by us hereinabove, particularly with regard to the Circular explaining Explanation 3-C, at the heart of the introduction of Explanation 3-C is misuse of the provisions of Section 43-B by not actually paying interest, but converting such interest into a fresh loan. On the facts found in the present case, the issue of debentures by the assessee was, under a rehabilitation plan, to extinguish the liability of interest altogether. No misuse of the provision of Section 43-B was found as a matter of fact by either CIT or ITAT. Explanation 3-C, which was meant to plug a loophole, cannot therefore be brought to the aid of the Revenue on the facts of this case. Indeed, if there be any ambiguity in the retrospectively added Explanation 3-C, at least three well-established canons of interpretation come to the rescue of the assessee in this case. First, since Explanation 3-C was added in 2006 with the object of plugging a loophole — i.e. *misusing* Section 43-B by not actually paying interest but converting interest into a fresh loan, bona fide transactions of actual payments are not meant to be affected. In similar circumstances, in *K.P. Varghese v. ITO* [*K.P. Varghese v. ITO*, (1981) 4 SCC 173 : 1981 SCC (Tax) 293], this Court construed Section 52 of the Income Tax Act as applying only to cases where “understatement” is to be found — an “understatement” is not to be found in the literal language of Section 52, but was introduced by this Court to streamline the provision in the

light of the object sought to be achieved by the said provision. This Court, therefore, held : (SCC pp. 189 & 191-92, paras 13 & 15)

“13. Thus it is not enough to attract the applicability of sub-section (2) that the fair market value of the capital asset transferred by the assessee as on the date of the transfer exceeds the full value of the consideration declared in respect of the transfer by not less than 15% of the value so declared, but it is furthermore necessary that the full value of the consideration in respect of the transfer is understated or in other words, shown at a lesser figure than that actually received by the assessee. Sub-section (2) has no application in case of an honest and bona fide transaction where the consideration in respect of the transfer has been correctly declared or disclosed by the assessee, even if the condition of 15% difference between the fair market value of the capital asset as on the date of the transfer and the full value of the consideration declared by the assessee is satisfied. ...

15. It is therefore clear that sub-section (2) cannot be invoked by the Revenue unless there is understatement of the consideration in respect of the transfer and the burden of showing that there is such understatement is on the Revenue. Once it is established by the Revenue that the consideration for the transfer has been understated or, to put it differently, the consideration actually received by the assessee is more than what is declared or disclosed by him, sub-section (2) is immediately attracted, subject of course to the fulfilment of the condition of 15% or more difference, and the Revenue is then not required to show what is the precise extent of the understatement or in

other words, what is the consideration actually received by the assessee. That would in most cases be difficult, if not impossible, to show and hence sub-section (2) relieves the Revenue of all burden of proof regarding the extent of understatement or concealment and provides a statutory measure of the consideration received in respect of the transfer. It does not create any fictional receipt. It does not deem as receipt something which is not in fact received. It merely provides a statutory best-judgment assessment of the consideration actually received by the assessee and brings to tax capital gains on the footing that the fair market value of the capital asset represents the actual consideration received by the assessee as against the consideration untruly declared or disclosed by him. This approach in construction of sub-section (2) falls in line with the scheme of the provisions relating to tax on capital gains. It may be noted that Section 52 is not a charging section but is a computation section. It has to be read along with Section 48 which provides the mode of computation and under which the starting point of computation is 'the full value of the consideration received or accruing'. What in fact never accrued or was never received cannot be computed as capital gains under Section 48. Therefore sub-section (2) cannot be construed as bringing within the computation of capital gains an amount which, by no stretch of imagination, can be said to have accrued to the assessee or been received by him and it must be confined to cases where the actual consideration received for the transfer is understated and since in such cases it is very difficult, if not impossible, to determine and prove the exact quantum of the suppressed consideration, sub-section (2) provides the statutory measure for determining the consideration

actually received by the assessee and permits the Revenue to take the fair market value of the capital asset as the full value of the consideration received in respect of the transfer.”

... ..

23. This being the case, Explanation 3-C is clarificatory — it explains Section 43-B(d) as it originally stood and does not purport to add a new condition retrospectively, as has wrongly been held by the High Court.

24. Third, any ambiguity in the language of Explanation 3C shall be resolved in favour of the assessee as per Cape Brandy Syndicate v. Inland Revenue Commissioner ([1921] (1) KB 64) as followed by judgments of this Court – See Vodafone international Holdings BV vs. Union of India [[2012] 7 taxmann.com 202/204 Taxman 408/341 ITR 1 at paras 60 to 70 per Kapadia, C.J. and paras 333, 334 per Radhakrishnan, J].”

Thus, from the aforesaid decision of the Supreme Court, it is evident that in the facts of each case, the issue whether the interest was actually paid has to be decided with reference to the fact whether the liability to pay the interest stands extinguished.

15. A Division Bench of the Gujarat High Court in **Core Emballage Limited** (supra) dealt with the claim of the assessee for deduction of the amount under Section 43B of the Act. The

assessee had issued equity shares against the outstanding interest liability. The Division Bench of the Gujarat High Court in the aforesaid decision followed the decision of the Supreme Court in **M.M.Aqua Technologies Limited** (supra) and held that the liability of the assessee to pay interest had ceased on account of issue of equity shares. The assessee was held entitled to benefit of Section 43B of the Act.

16. It is noteworthy that in the instant case, it is not the case of the Revenue that liability of the assessee to pay interest has not ceased to exist on issuance of equity shares. The claim of the assessee for deduction under Section 43B of the Act has been denied on the ground that the actual payment has not been made. In view of the interpretation put forth by the Supreme Court on Section 43B of the Act, as the liability of the assessee to pay interest ceased to exist on issue of shares in favour of APIDC, the same would tantamount to actual payment within the meaning of Section 43B of the Act. The assessee, therefore, is entitled to benefit of Section 43B of the Act.

17. For the aforesaid mentions, the substantial question of law is answered in favour of the assessee.

18. In the result, the appeal is allowed. The order dated 20.04.2006 passed by the Income Tax Appellate Tribunal, Hyderabad Bench-B, Hyderabad is set aside and the assessee is held entitled to claim the benefit of deduction under Section 43B of the Act. There shall be no order as to costs.

Miscellaneous applications, if any pending, shall stand closed. There shall be no order as to costs.

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Sd/- K. SRINIVASA RAO
JOINT REGISTRAR

SECTION OFFICER

To

1. The Income Tax Appellate Tribunal, Hyderabad Bench 'B', Hyderabad.
2. The Commissioner of Income Tax (Appeals)-II, Hyderabad
3. The Deputy Commissioner of Income Tax, Circle - 1 (3) Hyderabad.
4. One CC to SRI. A V KRISHNA KOUNDINYA Advocate [OPUC]
5. One CC to SRI. J V PRASAD, SC FOR INCOME TAX [OPUC]
6. Two CD Copies

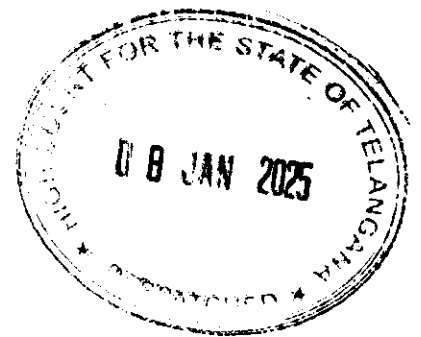
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HIGH COURT

DATED: 23/12/2024

**JUDGMENT
ITTA.No.239 of 2008**



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