IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH: 'I-2' : NEW DELHI

BEFORE SHRI R.S. SYAL, ACCOUNTANT MEMBER
AND
SHRI C.M. GARG, JUDICIAL MEMBER

ITA No. 3072/Del/2013
Assessment Year: 2008-09

First Blue Home Finance Ltd., (Now amalgamated with Dewan Housing Finance Corporation Ltd.) 201, Vipul Agora, M.G. Road, Near Sahara Mall, Gurgaon (PAN: AACD1977A) (Appellant)	Vs.	Deputy Commissioner of Income Tax, Circle- 10(1), New Delhi (Respondent)

Appellant by : Sh. H.P. Agarwal, CA
Respondent by : Sh. Gaurav Dudeja, Sr. DR

Date of hearing: 04.06.2015
Date of pronouncement: 05.06.2015

ORDER

PER R.S. SYAL, A.M.:

This appeal by the assessee is directed against the order passed by the CIT(A) on 15.03.2013 in relation to the assessment year 2008-09.

2. The only issue raised in this appeal is against the sustenance of addition towards transfer pricing adjustment on account of interest on the deemed loan resulting from the receipt of share application money equal to face value in full and final settlement of consideration, at value lower than the fair value estimated by the Transfer Pricing Officer (TPO).

3. Briefly stated the facts of the case are that the assessee is a 100% Indian subsidiary of BHW Holding AG (BHW Germany). It is engaged in the business of providing loans to retail customers for the construction or purchase of residential properties in India. Three international transactions were reported by the assessee in Form No. 3CEB. One transaction is of ñReceipt of share application moneyò with the transacted value of Rs. 53,30,96,400/-. We are not concerned with the other international transactions of ñGuarantee commissionò and `Reimbursement of expenses receivedô, which have been accepted by the authorities at armôs length price (ALP). On a reference made by the Assessing Officer (AO) to the TPO, the latter observed that the assessee demonstrated the international transaction of `Receipt of share applicationô at ALP by following the Comparable Uncontrolled Price (CUP) method as the most appropriate method. The TPO observed that the book value of each share of the assessee company at the beginning of the year stood at Rs. 11.98. The assessee was found to have received share application money against such shares from its AEs at the rate of Rs. 10 per share, equal to the face value, in full and final settlement of the issue of shares. Since the book value of the share was higher than the issued price, the TPO held it as a transaction of `transfer of assets of the companyô to its AEs in the guise of issue of share capital. It was opined that such under-charging of the price of shares was in the nature of a deemed loan given by the assessee to its AEs without any consideration. He held that the

assessee ought to have been compensated for such deemed loan with suitable interest. After entertaining objections from the assessee, the TPO determined the armôs length value of shares issued by the assessee company on the basis of its Annual report at Rs. 11.98 per share. Applying this benchmark as armôs length price of the share capital, the TPO treated the differential amount of Rs.10,55,53,087/- as deemed loan given by the assessee to its AEs. It was thereafter noticed that the assessee ought to have charged interest on such loan of Rs. 10.55 crore from its AEs. By applying the benchmark interest rate of 17.26% on such deemed loan, the TPO worked out the armôs length value of interest received at Rs. 15,18,205/-. Since no interest was received by the assessee on such deemed loan, the TPO proposed transfer pricing adjustment of equal amount at Rs. 15.18 lac. The Assessing Officer made this addition, which came to be affirmed in the first appeal. The assessee is aggrieved against the sustenance of this addition.

4. We have heard the rival submissions and perused the relevant material on record. The short question is whether any addition towards transfer pricing adjustment on account of interest on deemed loan can be made under the circumstances as are obtaining in the instant case. Section 92(1) of Income-tax Act, 1961 (hereinafter also called as ñthe Actò) provides that : ñAny income arising from an international transaction shall be computed having regard to the armôs length priceò. A bare perusal of this provision divulges that, firstly, there

should be an international transaction and secondly, such international transaction should result into income. When both these conditions are satisfied then the income so arising from an international transaction is computed having regard to its ALP. The reported international transaction is of the issue of 5,33,09,640 number of equity shares by the assessee to its AEs at the rate of Rs. 10 per share. This transaction of issue of shares was rightly considered by the assessee as an international transaction. There can be no doubt about the transaction of issue of share capital by a company to its AEs being characterized as non-international transaction. Section 92B gives meaning to `International transactionô. Sub-section (1) of this section provides that : `For the purposes of this section and sections 92, 92C, 92D and 92E, "international transaction" means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or é é . or any other *transaction having a bearing on the* profits, income, losses or *assets of such enterprises……*.ô. It is apparent from the definition of `international transactionô that it encompasses a transaction between two associated enterprises which, *inter alia,* has a bearing on assets of such enterprises. As the issue of shares by a company has direct bearing, *inter alia,* on its assets in terms of receipt of consideration, such transaction cannot be held to be anything other than an international transaction. The legislature has clarified this position beyond any pale of doubt by inserting clause (c) to the Explanation at the end of section 92B

through the Finance Act, 2012, w.r.e.f. 1.4.2002, providing that the international transaction shall include : `(c) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;ô This shows that the issue of share capital is an international transaction. Once there is an international transaction, the mandate of section 92C is triggered, which talks of computation of its arm's length price. Sub-section (1) of section 92C provides that : `The arm's length price in relation to an international transaction é .. shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribeé é .ô Then five specific methods have been provided and the lastly there is a general method as per clause (f), being, `such other method as may be prescribed by the Board.ôSecond condition for invoking the provisions of Chapter X of the Act is that some income should arise from an international transaction. It is only when some income chargeable to tax arises from an international transaction that the income so arising is substituted with the income determined on the basis of its ALP. Thus, it is apparent that if an international transaction with its determined ALP does not lead to the generation of any income chargeable to tax, then the provisions of

section 92(1) are not magnetized. The Hon'ble Bombay High Court in *Vodafone India Services Pvt. Ltd. Vs. Additional Commissioner of Income Tax, (2014) 368 ITR 1 (Bom.)* has held that Chapter-X of the Act does not contain any charging provision but is a machinery provision to arrive at ALP of a transaction between two or more Associated Enterprises. It has further been held that this Chapter does not change the character of the receipt but only permits re-quantification of income uninfluenced by the relationship between the Associate

5. In such circumstances the moot question which arises for our consideration is whether the transaction of receipt of share application money leads to generation of any income chargeable to tax in the hands of the assessee company proposing to issue shares, warranting the substitution of such income with income determined on the basis of its ALP. An income is chargeable to tax, if it is either of a revenue character or of a capital nature having been specifically included in the ambit of income under the Act. The definition of income does not specifically include within its purview any capital receipt arising on issue of share capital. Thus it follows that the issue of shares at par or premium is a transaction on capital account, which does not affect the computation of total income of a company. Here it is important to mention that the Finance Act, 2012 w.e.f. 01.04.2013 has inserted clause (viib) to section 56(2) of the Act, the relevant part of which provides as under:

> `(viib) where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being *a resident,* any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares:é é é .ô

6. The above provision makes it explicit that where a company, not being a one in which public are substantially interested, receives consideration for issue of shares exceeding the fair market value of the shares, then the consideration received for such shares as exceeds the fair market value of the shares is considered as income under the head ñIncome from other sourcesò. To put it simply, if a share with the face value of Rs.10 is issued for Rs.50 and the fair market value of such share is Rs.15, then the excess premium received amounting to Rs.35 (Rs.50 minus Rs. 15) shall be treated as the income of the company chargeable under this provision. It is further relevant to note that this provision is attracted only when the share capital is issued to any person being a resident. *Au contraire*, if the shareholder is a non-resident then the mandate of this provision does not apply. The position which ergo follows is that prior to the insertion w.e.f. 01.04.2013 there was no provision under the Act providing for charging excess share premium to tax. In our considered opinion, this provision has no application on the instant assessee for two reasons. First, we are dealing with the assessment year 2008-09 and it is obvious that section 56(2)(viib) has been inserted w.e.f. 1.4.2013 and further there is nothing to indicate that it has a retrospective operation. Second, the assessee company

issued shares to its non-resident AEs and section 56(2)(viib) applies only when a shareholder is resident. Moreover, this provision operates only when the company issues shares at a price above the fair market value and not *vice versa*. On the other hand, we are confronted with a converse situation, in which the assessee company, as per the opinion of the authorities below, has received share application equal to the face value of share in full and final settlement at a price less than the fair market value. Once neither the amount of face value of the shares issued nor the expected share premium leads to the accrual of an income chargeable to tax in the hands of the issuing company, there can be no question of substituting the transacted value of the international transaction with its ALP.

7. The Hon'ble Bombay High Court in *Vodafone India Services Pvt. Ltd. (supra)* had an occasion to consider a case in which the Indian company issued shares to its non-resident holding company at a premium which was held by the TPO to be inadequate. A higher amount of premium, in the opinion of the TPO, was chargeable by the Indian enterprise. Since lower amount was charged, it was held that the differential amount of share premium not charged by the Indian enterprise was a deemed loan to the foreign company and as such, the addition on account of transfer pricing adjustment was made on this score. Repelling such a point of view, the Hon'ble High Court held that the provisions of Chapter X are not applicable to the international transaction of issue of equity

shares by the resident company to its non-resident holding company at certain value, since neither the capital receipt by the resident company on issue of equity shares to its non-resident holding company nor shortfall between the fair market price of the equity shares and the issue price of equity shares, can be considered as income within the meaning of the expression as defined under the Act. Respectfully following the precedent, we hold that there can be no question of treating the alleged uncharged share premium by the assessee company leading to an addition on account of transfer pricing adjustment. The TPO has rightly not made any addition on account of the lesser share premium charged by the assessee, which amount was worked out by him at Rs.10.55crore. Rather, this amount has been treated as a deemed loan on which addition towards transfer pricing adjustment of interest has been made amounting to Rs.15.18 lac. Now the question is about the legality or otherwise of such addition.

8. The Hon'ble Bombay High Court in *Vodafone (supra),* having held that no addition on account of transfer pricing adjustment is contemplated in respect of less share premium received by the assessee from its AE, proceeded further to examine the effect of the transactions on capital accounts on the total income. The relevant observations have made in para 31 of the judgment, which are as under:

> `31 Similarly, the reliance by the revenue upon the definition of International Taxation in the sub clause (c) and (e) of Explanation (i) to Section 92B of the Act to conclude that Income has to be given a broader meaning to include notional income, as otherwise Chapter X of the Act would be rendered otiose is farfetched. The issue of shares at a premium does not exhaust the universe of applicability of Chapter X of the Act. There are transactions which would otherwise qualify to be covered by the definition of International Transaction. *The transaction on capital account or on account of restructuring would become taxable to the extent it impacts income i.e. under reporting of interest or over reporting of interest paid or claiming of depreciation etc. It is that income which is to be adjusted to the ALP price. It is not a tax on the capital receipts.* This aspect appears to have been completely lost sight of in the impugned order.ô

9. On going through the above extracted observations of the Hon'ble Bombay High Court, the overall *ratio* of the entire judgment can be culled out that though the international transaction on capital account itself would not lead to generation of any income because of the transfer pricing adjustment, but the international transaction on capital account, which impacts income, such as, *under reporting of interest or over reporting of interest paid or claiming of depreciation etc.* is required *to be adjusted to the ALP price,* which *is not a tax*

on the capital receipts. The effect of this judgment on a holistic basis is that though the international transaction on capital account *per se* cannot call for any addition on account of transfer pricing adjustment because of the absence of any provision under the Act charging income from such transactions, but the transactions flowing out of such original transaction on capital account, having impact on the profitability of the assessee, would be required to pass the mandate of Chapter-X of the Act. In other words, if such offshoot transactions of the original transaction on capital account, such as, interest or depreciation are not at armôs length price, then it is mandatory to determine their ALP and make addition, if any, on account of transfer pricing adjustment. It can be understood with the help of a simple example. Suppose an Indian company purchases some asset from its AE at a consideration of Rs.300 (the armôs length price of which is Rs.100), on which it claims depreciation of Rs.30 at the rate of 10% on such purchase consideration. Now the TPO can rightly determine the ALP of the international transaction of purchase of asset at Rs.100. Since the transaction of purchase of asset is on capital account, there can be no addition of Rs.200 (Rs.300 minus Rs.100), being the difference between the ALP and transacted value. However this international transaction of purchase of asset on capital account having impact on the income of the assessee by means of transaction of claim of depreciation *is to be adjusted to the ALP price.* Consequently, the TPO will be within his jurisdiction to determine the ALP of

the transaction of claim of depreciation by reducing it to Rs.10 on the basis of the ALP of the international transaction on capital account, for which no addition of Rs.200 is maintainable. Similar is the position as regards the *under reporting of interest* on an international transaction on a capital account.

10. The Hon'ble Bombay High Court in *Shell India Markets Pvt. Ltd. Vs. ACIT and Others, (2014) 369 ITR 516 (Bom.)* has dealt with a case in which equity shares were allotted by an Indian enterprise to its non-resident AEs at face value. The TPO enhanced the value of shares from the face value of Rs.10 to Rs.183.44 per share and computed the ALP of this transaction accordingly. Apart from making the resultant addition on account of such transaction on capital account, he also held that interest on the deemed loan due to short receipt of the consideration resulting in transfer pricing adjustment, was also to be made. Such interest was also benchmarked and addition was made. The Hon'ble High Court, following the judgment in *Vodafone India Services Pvt. Ltd. (supra)* held that there can be no addition by applying the provision under Chapter-X on account of less share premium received and also the consequential interest on the resultant deemed loan. The learned DR has not drawn our attention towards any contrary judgment not mandating the determination of ALP of interest on deemed loan consequent upon issue of shares by an Indian company to its non-resident AE at lower price than its fair market value. Respectfully following the precedent, we hold that the addition of Rs. 15.18 lac

on account of interest on the deemed loan due to under-receipt of share premium, upheld by the learned CIT(A), cannot be sustained. Accordingly, the addition is deleted and the ground is allowed.

11. In the result, the appeal is allowed.

The decision is pronounced in the open court on 5th June, 2015.

Sd/-	**Sd/-**
(C.M. GARG)	**(R.S. SYAL)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Dated: 5th June, 2015.
RK/-
Copy forwarded to:
1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR

Asst. Registrar, ITAT, New Delhi

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