

TT Alert

December 2020

Karnataka High Court treats discount on issue of debentures as a deductible expenditure to be proportionately claimed over the period of redemption

The Hon'ble Karnataka High Court in its recent ruling¹ has held that discount given at the time of issuance of debentures which are to be redeemed in stages over a period of five years shall be allowed as a deduction on a proportionate basis which is to be spread across the period of redemption of such debentures.

Background

The Assessee is a public limited company engaged in the business of manufacture of metal package and cans. The Assessee during FY06 (i.e. Assessment Year 2006-07) had issued 9% Secured Redeemable Preference Shares of INR 100 at an aggregate value of INR 38 cr. at a discounted value of INR 33 cr.

As per the terms agreed at the time of issuance of debentures, the debentures were to be redeemed over a period of 5 years on a proportionate basis as under:

Period	Percentage of Redemption Value
Year 1 (FY06)	10%
Year 2 (FY07)	15%
Year 3 (FY08)	20%
Year 4 (FY09)	25%
Year 5 (FY10)	30%

The Assessee while filing its tax return for FY06, had claimed a one-time deduction of INR 5 cr. as 'discount on issuance of debentures' representing the difference between aggregate value of debentures and the value at which such debentures were issued.

While the total amount of INR 5 cr. representing the discount on issuance of debentures was claimed as a deduction in Year 1 itself, accounting-wise, the Assessee had spread the said discount during the entire period of redemption of debentures in proportion in which the debentures were to be redeemed i.e., over a period of 5 years.

¹ Shetron Limited Vs Deputy Commissioner of Income-tax [2020] 122 Taxmann.com 84 (Karnataka)

The Assessing Officer ('AO') during the course of tax assessment disallowed the deduction of INR 5 cr. claimed by the Assessee and restricted the deduction towards such discount to INR 50 lacs only (i.e. 10% of the total discount).

The Assessee during the course of the proceedings before the AO contested that the proceeds received from issuance of debentures were utilized towards settlement of the loan obligation of the Assessee under One time Settlement Scheme ('OTS') with IDBI Bank and the entire benefit received in the form of interest waiver under the said Scheme was offered to tax.

As the entire benefit of OTS scheme was offered to tax, even the cost to be borne in the form of discount on issuance of debentures was entirely claimed as a deduction, while computing the taxable income for FY06.

The aforesaid contention of the Assessee was rejected by the AO and hence, the Assessee contested the matter before the Commissioner of Income-tax Appeals ('CIT (A)').

The CIT (A) upheld the contention of the Assessee and allowed the total amount of INR 5 cr. as discount on issuance of debentures in Year 1 itself. Aggrieved by the order of the CIT (A), the AO filed an appeal before the Hon'ble Appellate Tribunal (ITAT).

The Hon'ble ITAT basis facts of the case, held that the Hon'ble CIT (A) had not recognized the fact that basis terms agreed at the time of issuance, such debentures were to be redeemed in a phased manner and the benefit of the expenditure associated with issuance of debentures (i.e. discount at the time of issuance) would accrue over a period of time. Thus, the deduction in respect of such expenditure should be allowed on a proportionate basis spread over the period of redemption.

The Hon'ble ITAT further held that the AO has rightly by relying on the decision of the Hon'ble Supreme Court in case of Madras Industrial Investment Corpn Ltd. v. CIT (225 ITR 802) had allowed only portion of the discount (i.e. INR 50 lacs) as an allowable deduction in FY06 which was in proportion of the debentures which were to be redeemed in the said year.

Aggrieved by the order of the Hon'ble ITAT, the Assessee filed an appeal before the Hon'ble High Court wherein the following was held:

What the Hon'ble High Court held

- The amount representing discount towards issuance of debentures was not actually incurred by the Assessee and represents a notional amount which was recorded in the books pursuant to an event of issuance of debentures.
- The proceeds received on issuance of debentures were utilized by the Assessee for its business purposes and thus the discount associated with issuance of such debentures will be treated as an 'expense' incurred for the purpose of business.
- The Hon'ble High Court by placing reliance on the ruling of the Hon'ble Supreme Court in case of Madras Industrial Investment Corpn Ltd. v. CIT (225 ITR 802) (which was also relied upon by the Hon'ble ITAT), observed that expenditure incurred wholly and exclusively for business purposes should be allowed fully in the year of their incurrence even if for the purpose of books the said expenditure has been spread over a period of time.
- However, basis reliance placed on aforesaid ruling, the Hon'ble High Court also observed that there could be cases wherein the Assessee basis, specific facts of the case, could be allowed to spread the claim of expenditure over a period of time wherein such deduction would be allowed on a proportionate basis.
- Issuance of debentures at a discount is one such instance wherein the discount provided at the time of their issuance results in securing a benefit for the business over a specified number of years i.e. till the time debentures are redeemed. Accordingly, the deduction in respect of such discount should also be spread over the period for which debentures exist.
- When entire amount of discount on issuance of debentures is allowed to be claimed as a deduction in the year of issuance it- self, the same will not present a correct picture as far as taxable profits of the aforesaid said year is concerned.
- Accordingly, the discount which was offered at the time of issuance of debentures by the Assessee should be allowed as a deduction in proportion to the redemption value of debentures over a period of five years.

Case Laws Relied by the Assessee

- Taparia Tools Ltd. v. Jt. CIT [2015] 55 taxmann.com 361/231 Taxman 5/372 ITR 605 (SC)

Case Laws Relied by the Revenue

- Madras Industrial Investment Corpn. Ltd. v. CIT [1997] 91 Taxman 340/225 ITR 802 (SC)

RBSA Take

The Apex Court in Taparia Tools (Supra) as well as various other High Courts while interpreting and relying on the decision of Madras Industrial (Supra) have held that ordinarily all expenses are to be claimed as deduction in the year in which they are incurred and only if the assessee itself wants to spread the expense over the years, the criteria of matching concept should be satisfied. Thus, the question of matching concept arises only when the expenses are spread over, which is to be done at the instance of assessee. If an assessee wants to claim the expenses in a particular year, the application of the principle of matching concept is not warranted.

It may be observed that in the case of Madras Industrial (Supra), it was the assessee who wanted to spread the expenses over the years. The same was allowed by the Apex Court on the ground of satisfying the matching concept. This aspect of deduction being spread out over the years at the instance of the assessee is clearly pointed out in para 17 of the judgment of Taparia Tools (Supra) as well as in various other judicial precedents [Please see: CIT v. Industrial Finance Corporation of India Ltd, (2009) 185 Taxman 296 (Del HC) (para 23 and 24)].

Even in the instant case before the Hon'ble Karnataka High Court, the assessee wanted to claim the entire expenditure in the first year itself and accordingly relied on Madras Industrial (Supra) and Taparia Tools (Supra) while making such claim.

However, the Hon'ble Karnataka High Court has applied the principle of matching concept, inversely and held that since the assessee has failed to satisfy the matching principle, the entire expenses cannot be claimed in a particular year.

There are quite a few precedents wherein expenses from discount on issue of debentures or premium on redemption of debentures have been allowed on a proportionate basis. However, most of these were prior to the decision of Apex Court's decision in Taparia Tools (supra).

Additionally, the spill-over of expense claim over the tenure is not an issue restricted only to the discount on issue of debentures. Several variety of transactions also faced a similar concern. These include:

- i. Stamp duty paid on contract/lease spanning over several years
- ii. Expense on account of ESOPs
- iii. Expense incurred on Voluntary Retirement Scheme
- iv. Consideration payable on account of pre-redemption of debentures.
- v. Premium on redemption of debentures

Numerous High Courts have held that such expenses are to be claimed in the year in which they are incurred and are not to be spread across proportionately.

Accordingly, we are of the view that the above case of Karnataka High Court may have to be tested further and should not be considered as a conclusive decision while claiming such deductions.



Ranked No. 2

By:
Deal Amount & Deal Count



Ranked No. 4

By:
Deal Amount

Ranked No. 3

By:
Deal Count

RBSA Advisors has been ranked #2 for both deal value & deal count by Venture Intelligence, and ranked #4 for deal value & ranked #3 deal count by MergerMarket for H1'20 (Jan-June), in the league table rankings for M&A Advisory firms in India.

For any further details or questions, please contact us:

India Offices

Ravi Mehta

Managing Director & Head
Transaction Tax
ravi.mehta@rbsa.in
+91 22 6130 6052

Mumbai

1121, Building No. 11, 2nd Floor,
Solitaire Corporate Park, Chakala,
Andheri Kurla Road, Andheri (E),
Mumbai - 400 093
Tel: +91 22 6130 6000

Delhi

2nd Floor, IAPL House,
23 South Patel Nagar,
New Delhi - 110 008
Tel: +91 11 2580 2300
+91 99585 62211

Sidharth Dhir

Director
Transaction Tax
sidharth.dhir@rbsa-advisors.com
+91 22 6130 6071

Ahmedabad

912, Venus Atlantis Corporate Park,
Anand Nagar Road, Prahladnagar,
Ahmedabad - 380 015
M: +91 97243 44445
Tel: +91 79 4050 6000

Bengaluru

104, 1st Floor, Sufiya Elite,
#18, Cunningham Road,
Near Sigma Mall,
Bangalore - 560 052
M: +91 97435 50600
Tel: +91 80 4112 8593

Kolkata

9th Floor, KAHM Tower,
13, Nellie Sengupta Sarani,
Kolkata - 700 087
Tel: +91 33 460 34731

Hyderabad

607, 6th Floor, Shangrila Plaza,
Road No. 2, Opposite KBR Park,
Banjara Hills,
Hyderabad - 500 034
M: +91 90526 60300

Global Offices

Dubai

2001-01, Level 20, 48 Burj Gate Tower,
Downtown, Sheikh Zayed Road,
PO Box 29734, Dubai, UAE
M: +971 52 382 2367
+971 52 617 3699
Tel: +971 4518 2608
Email: dubai@rbsa.in

Singapore

105 Cecil Street,
22-00 The Octagon,
Singapore - 069 534
M: +65 8589 4891
Email: singapore@rbsa.in

enquiry@rbsa.in
www.rbsa.in