| आयकर अपीलीय अधिकरण न्यायपीठ, मुंबई |
IN THE INCOME TAX APPELLATE TRIBUNAL
"B" BENCH, MUMBAI

BEFORE SHRI SAKTIJIT DEY, HON'BLE VICE PRESIDENT
&
SHRI NARENDRA KUMAR BILLAIYA, HON'BLE ACCOUNTANT MEMBER

I.T.A. No. 1418/Mum/2025
Assessment Year: 2017-18

N V Projects Private Limited Ground Floor, Block D S. No. 30/3, 31/1 & 2A Weikfield IT Citi Info Park Viman Nagar Pune - 411041 **[PAN: AACCD2669P]**	Vs	**Deputy Commissioner of Income Tax, Circle 1(2)(2), Mumbai**
अपीलार्थी/ (Appellant)		प्रत्यर्थी/ (Respondent)

I.T.A. No. 1025/Mum/2025
Assessment Year: 2017-18

Deputy Commissioner of Income Tax - 5(2)(1), Mumbai	Vs	**N V Projects Private Limited** Ground Floor, Block D S. No. 30/3, 31/1 & 2A Weikfield IT Citi Info Park Viman Nagar Pune - 411041 **[PAN: AACCD2669P]**
अपीलार्थी/ (Appellant)		प्रत्यर्थी/ (Respondent)

Assessee by :	Shri Vijay Mehta, A/R
Revenue by :	Shri Satyaprakash R. Singh, CIT, D/R

सुनवाई की तारीख/**Date of Hearing : 16/09/2025**
घोषणा की तारीख /**Date of Pronouncement: 1809/2025**

आदेश/**O R D E R**

PER NARENDRA KUMAR BILLAIYA, AM:

I.T.A. No. 1418/Mum/2025 & I.T.A. No. 1025/Mum/2025 are cross-appeals by the assessee and the revenue preferred against the order dated 18/12/2024 by NFAC, Delhi [hereinafter "the ld.CIT(A)"], pertaining to AY 2017-18.

2. We first take up the assessee's appeal in ITA No. 1418/Mum/2025.

3. The solitary grievance of the assessee is that the ld. CIT(A) erred in sustaining the disallowance of Rs. 11,56,72,935/- made u/s 36(1)(iii) of the Act by the AO.

4. Briefly stated the facts of the case are that the assessee filed its return of income on 31/10/2017 declaring total income at Rs.3,57,13,060/-. The return was selected for scrutiny assessment and accordingly statutory notices were issued and served upon the assessee. The assessee is engaged in the business of operation and maintenance of an information technology Park. During the course of scrutiny assessment proceedings and on perusal of the notes to the accounts, the AO found that during the year under consideration pursuant to the approval of the Hon'ble Bombay High Court, the assessee has been permitted to reduce its capital by cancelling up to a maximum of 2 lakhs preference shares of Rs. 100/- each fully paid up and returning the said capital to the preference shareholders of an aggregate amount not exceeding Rs. 70 crores/-. Accordingly, the assessee reduced the number of preference shares from 253185 by cancelling 165433 redeemable optionally convertible shares of Rs. 100/- each and returning capital to the preference shareholders at Rs. 4050/- per redeemable optionally convertible preference shares of Rs. 100/- each aggregating to Rs.67,00,03,650/- as per the scheme sanctioned by the Hon'ble High Court of Bombay.

4.1. The premium of Rs. 3950/- per share payable on capital reduction of 165433 redeemable OCPs, aggregating to Rs.65,34,60,350/- was

partly adjusted to the extent of Rs. 16,89,73,947/- against the balance in the surplus in the statement of profit and loss account and balance amounting to Rs. 48,44,86,403/- was adjusted against the balance in the revaluation reserve and both the accounts stood reduced to that effect.

4.1.1. The AO further found that the assessee has borrowed funds to be utilised for payment to shareholders on capital reduction and questioned the interest thereon. The AO was of the opinion that the interest thereon should be treated as capital expenditure in nature. The AO based his belief that the loan has been used for the purpose of capital reduction undertaken by the company on which interest expenditure of Rs. 11,56,72,935/- has been incurred. The assessee has claimed this interest as revenue expenditure. Accordingly, the assessee was issued a showcause notice as to why the same should not be disallowed u/s 36(1)(iii) of the Act. The assessee filed detailed reply claiming that section 36(1)(iii) of the Act is a self-contained code and it has to be read in its own terms. It was explained that the borrowing of the loan and actual application thereto are two separate transactions. The provisions of Section 36(1)(iii) of the Act attracts the transaction of the borrowing and not transaction of investment. It does not distinguish whether the loan is borrowed for the revenue purpose or the loan is borrowed for a capital purpose and the assessee is entitled to claim interest paid on borrowed loan provided the loan is used for the purpose of business irrespective of what may be the result of using the loan which the assessee had borrowed. It was strongly contended that the assessee has satisfied all the prescribed conditions u/s 36(1)(iii) of the Act.

4.2. The submissions made by the assessee did not find any favour with the AO who continue his belief that the assessee has borrowed funds to repay shareholders and it is well established that expenditure incurred for payment of owners' fund does not tantamount to expenditure incurred for the purpose of business and profession. The AO reiterated that u/s 36(1)(iii) of the Act, interest can be allowed only if the assessee proves that the same is for the business purpose. Referring to various judicial decisions the AO disallowed interest paid of Rs. 11,56,72,935/-.

4.3. The assessee challenged the addition before the ld. CIT(A) but without any success.

5. Before us, the ld. Counsel vehemently stated that there is no dispute regarding the reduction of the capital which scheme has been approved by the Hon'ble High Court of Bombay. The assessee had borrowed money for the payment to the shareholders which has also not been doubted by the AO. The only reason given by the AO is that interest paid on the money borrowed for reduction of capital is not for the purpose of business. The ld. Counsel placed reliance on the decisions of the Hon'ble High Court of Gujarat in the case of *Deputy Commissioner Of Income-Tax vs Core Healthcare Ltd [2001]251 ITR 61(Guj)* and the Hon'ble Supreme Court in the case of *Eastern Investments Limited v. Commissioner of Income-tax (1951) 20 ITR 1 (SC).*

The ld. D/R placed strong reliance on the assessment order and the order of the ld. CIT(A) and read the operative part.

6. We have carefully considered the orders of the authorities below and the judicial decisions relied upon by the ld. Counsel. The

undisputed facts are that the articles of association of the assessee company authorises the assessee company which can from time to time, by special resolution, reduce its capital in any manner authorised by law. Pursuant to such powers conferred upon it, the board passed special resolution to reduce its capital and the said resolution has been approved by the Hon'ble High Court of Bombay. In order to reduce its capital as approved by the Hon'ble High Court of Bombay, the assessee utilized the borrowed funds and paid interest thereon and claimed it as revenue expenditure. The entire quarrel revolves around the allowability of such interest payment u/s 36(1)(iii) of the Act, which provides as under:-

> *"36(1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in Section 28 -*
> *(i) and (ii)*******
> *II the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession :-*
> *Provided that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset for extension of existing business or profession (whether capitalized in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.*
> *Explanation. - Recurring subscriptions paid periodically by shareholders, or subscribers in Mutual Benefit Societies which fulfill such conditions as may be prescribed, shall be deemed to be capital borrowed within the meaning of this clause."*

7. In light of the aforementioned provisions, the assessee is required to fulfil the following conditions:-

(i) the assessee must have borrowed money.

(ii) the borrowing must be for the purpose of business &;

(iii) the assessee must have paid interest on the borrowed amount which he has shown as an item of expenditure.

7.1. There is no dispute that the assessee has borrowed money and there is no dispute that the assessee has paid interest thereon. The only dispute is that whether the money so borrowed has been utilized for the purpose of business. Now, the moot question which needs our consideration is whether reduction of share capital amounts to "for the purpose of business".

8. The Hon'ble Gujarat High Court in the case of *Core Healthcare Ltd. (supra)*, has observed as under :-

> *"There is an inherent indication in the Act that any expenditure which is in the nature of capital expenditure would not be allowable as a deduction while computing the income chargeable under the head "Profits and gains of business or profession" as laid down in Section 37 of the Act ; but in the same section the portion in parenthesis lays down that such expenditure has to be "not being expenditure of the nature described in Sections 30 to 36". Therefore, there is a specific provision dealing with interest paid/payable in respect of the borrowings incurred for the purposes of business and hence the general provision viz., Section 37 of the Act cannot come into play. Therefore, whether the interest is paid for a borrowing which is utilised for acquisition of capital asset or which is utilised for a revenue purpose loses its distinction and if that be so the stand adopted by the Revenue that in respect of interest which is capitalised, after the commencement of the business but before an asset is first put to use cannot be allowed as a revenue deduction under Section 36(1)(iii) of the Act is against the plain language of the provisions of the Act."*

8.1. This decision of the Hon'ble Gujarat High Court has been upheld by the Hon'ble Supreme Court in *Core Health Care Ltd. 298 ITR 194 (SC).*

9. The Hon'ble Supreme Court in the case of *Eastern Investments Limited v. Commissioner of Income-tax (supra)* had the occasion to consider a situation where the company agreed to reduce its share capital by ₹ 50 lakhs and the shareholder agreed to forgo cash payment and agreed instead to receive debentures of face value of ₹ 50 lakhs carrying interest at 5% per annum. The claim of interest paid on such debenture as expenditure was the subject matter of the quarrel before the Hon'ble Court. The Hon'ble Supreme Court observed as under:-

"The next point on which some stress was placed was that there was complete identity of person between the person whose shares were sold and the person who took the debentures and that the transaction resulted in considerable benefit to him. In the absence of a suggestion of fraud this is not relevant at all for giving effect to the provisions of section 12(2) of the Income tax Act. Most commercial transactions are entered into for the mutual benefit of both sides, or at any rate each side hopes to gain something for itself. The test for present purposes is not whether the other party benefitted, nor indeed whether this was a prudent transaction which resulted in ultimate gain to the appellant, but whether it was properly entered into as a part of the appellant's legitimate commercial undertakings in order indirectly to facilitate the carrying on of its business."

9.1. And further observed as under:-

"On a full review of the facts it is clear that this transaction was voluntarily entered into in order indirectly to facilitate the carrying on of the business of the company and was made on the ground of commercial expediency. It therefore falls within the purview of section 12(2) of the Income-tax Act, 1922 before its amendment in 1939."

9.2. The Hon'ble Supreme Court has set at rest the allegations made by the AO/ld. CIT(A) that the impugned transaction is not carried out for the purpose of business. The Hon'ble Supreme Court has clearly laid down the following test :-

"The test for present purposes is not whether the other party benefitted, nor indeed whether this was a prudent transaction which resulted in ultimate gain to the appellant, but whether it was properly entered into as a part of the appellant's legitimate commercial undertakings in order indirectly to facilitate the carrying on of its business."

[Emphasis supplied]

10. Considering the facts of the case in totality in light of the decisions discussed hereinabove, the disallowance of interest u/s 36(1)(iii) of the Act is uncalled for and is directed to be deleted.

11. We now take up the revenue's appeal in I.T.A. No. 1025/Mum/2025,

12. The grievance of the revenue reads as under:-

"1. "Whether on the facts and in the circumstances of the case and in law, the Ld. CITYA) erred in deleting the tax levied under Section 115QA of the Income-fax Act, 1961, on the capital reduction undertaken by the assessee, failing to appreciate that the said transaction amounts to buyback of shares and distribution of profits,

and is therefore liable to tax as per the provisions of the said section 115QA of the Act?"

2. "Whether on the facts and in the circumstances of the case and in law, the Ld, CIT(A) erred in ignoring Explanation fil) to Section 115QA, which defines distributed income' and mandates that tax be levied on the excess consideration paid over the issue price, thereby incorrectly holding that the capital reduction in question does not result in any buyback' as contemplated under the Act?"

3. "Whether on the facts and in the circumstances of the case and in law, the Ld. CITA) erred in failing to appreciate the principle laid down by the Hon'ble Supreme Court in the case of K.P, Varghese v. TO /(1981) 131 IR 597 (SC), which emphasizes that the substance of a transaction must he considered over its form, and thereby overlooking that the capital reduction was, in effect, a buyback of shares?"

4. "Whether on the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in disregarding the binding precedents laid down by the Hon'ble Supreme Court in. Vodafone International Holdings B.V. u. UOI (2012) 341 TR 1 (SC) and the Hon'ble Delhi High Court in Cairn India Lid. v. DCIT (2019) 414 MR 300 (Del), which categorically hold that capital reduction resulting in payments to shareholders is akin to a buyback and consequently liable to tax under Section 115QAP"

5. "Whether on the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in deleting interest levied u/s 115QB of the Act which is chargeable as the company distributing profit failed to deposit tax payable w/s 115QA within 14 days of the date of payment of consideration to the shareholders on buyback of shares.

6. "The appellant prays that the order of the CIT(A) on the grounds be set aside and confirms the order of the AO."

7. "The appellant craves leaves to add, amend or alter all or any of the grounds of appeal."

13. Briefly stated, the facts of the case are that during the course of scrutiny assessment proceedings, on finding that there was a capital reduction by the assessee during the year, the AO issued the following showcause notice to the assessee:-

> *"It is observed from your submissions during assessment proceedings that during the year, you have undertaken the process of capital reduction pursuant to Hon'ble Bombay High Court Order, whereby you have cancelled 1,65,433 ROCPS (Redeemable Optionally Convertible Preference Shares) of Rs 100 each on 19.05.2016 and you have paid Rs 67,00,03,650/- to the ROCPS holders on 31.05.2016 i.e., @ Rs 4,050 per share. The said payment attracts the provisions of Section 115QA of the Income Tax Act 1961."*

14. The assessee was further asked to explain the following:-

> *"1. Please explain when the above Equity shares were issued and at what price, with supporting evidences? In case there has been any transfer of the same, please submit*

complete details of transferor/ transferee, and the price at which such transfer taken place, with supporting evidences.

2. Please submit copy of the High Court Order, and relevant document evidencing the cancellation of above Equity shares.

3. Please submit copy of relevant Bank Statement showing the payments made to above Equity shareholders.

4. Please show cause as to why additional tax u/s 115QA r.w.r. 40BB should not be levied in the case."

15. The assessee filed a detailed reply stating that Section 115QA was amended by Finance Act, 2016 *w.e.f.* 01/06/2016, to broaden the definition of buy-back to mean buy-back under any law and not just to buy-back u/s 77 of the Companies Act, 1956. Since the scheme of reduction was 16/04/2016 which was prior to the amended law, therefore, Section 115QA of the Act is not applicable on the facts of the case in hand. This contention of the assessee was dismissed by the AO who went on to apply the provisions of Section 115QA of the Act on the distributed income of Rs. 65,34,60,350/- and computed the tax liability @ 20% + surcharge & cess, determining the liability at Rs. 15,07,66,372/- and also levied interest @ 1% per month u/s 115QB of the Act amounting to Rs. 6,48,29,540/-.

15.1. The assessee challenged the additions before the ld. CTI(A) and reiterated its claim that the amendment is not applicable to the assessee on the given facts of the case. After considering the facts and the submissions of the related amendment by the Finance Act, 2016 to the provision of Section 115QA of the Act *w.e.f.* 01/06/2016, the ld. CIT(A) observed that prior to the amendment, the provisions of Section 115QA of the Act were limited to buy-back of shares whereas the assessee has made reduction in the share capital and since the assessee has made the

payment prior to 01/06/2016, the ld. CIT(A) directed the AO to verify whether the payments were received by the investor/shareholders prior to 01/06/2016.

16. Insofar as the dates of payment is concerned, there is no quarrel. The only dispute relates to the applicability of the provisions of Section 115QA of the Act after the amendment. There is no ambiguity that Finance Act, 2016 has made the amendment to Section 115QA *w.e.f.* 01/06/2016 and since there is no quarrel insofar as the payment made by the assessee to its shareholder is concerned as the same is prior to 01/06/2016, the amended provisions did not apply to the assessee. Therefore, there is not error or infirmity in the findings of the ld. CIT(A).

17. In the result, appeal of the assessee is allowed and appeal of the revenue is dismissed.

Order pronounced in the Court on 18th September, 2025 at Mumbai.

Sd/-	*Sd/-*
(SAKTIJIT DEY)	**(NARENDRA KUMAR BILLAIYA)**
VICE PRESIDENT	**ACCOUNTANT MEMBER**

Mumbai, Dated 18/09/2025
SC SA

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent
3. संबंधित आयकर आयुक्त / Concerned Pr. CIT
4. आयकर आयुक्त (अपील) / The CIT(A)-
5. विभागीय प्रतिनिधि ,आयकर अपीलीय अधिकरण, मुंबई /DR,ITAT, Mumbai,
6. गार्ड फाई/ Guard file.

आदेशानुसार/ **BY ORDER**
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Assistant Registrar
आयकर अपीलीय अधिकरण
ITAT, Mumbai