2021 INSC 397

REPORTABLE

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NOS.4742-4743 OF 2021

(Arising out of SLP (Civil) Nos. 35883-35884 of 2016)

M.M. Aqua Technologies Ltd. … Appellant

Versus

Commissioner of Income Tax, Delhi-III … Respondent

J U D G M E N T

R.F. Nariman, J

1. Leave granted.

2. The question raised in these appeals is with particular reference to Section 43B Explanation 3C of the Income Tax Act, 1961 [the **"Act"**]. The brief facts necessary to appreciate the controversy raised in these appeals are as follows.

3. On 28th November, 1996, the Appellant filed a return of income declaring a loss of Rs.1,03,18,572/- for the assessment year 1996-1997. In the return filed by it, the Appellant claimed a deduction of Rs.2,84,71,384/- under Section 43B based on the issue of debentures

in lieu of interest accrued and payable to financial institutions. By an order dated 29th October, 1998, the Assessing Officer rejected the Appellant's contention by holding that the issuance of debentures was not as per the original terms and conditions on which the loans were granted, and that interest was payable, holding that a subsequent change in the terms of the agreement, as they then stood, would be contrary to Section 43B(d), and would render such amount ineligible for deduction. The Commissioner of Income Tax (Appeals) ["**CIT**"] allowed the appeal and held, on facts, as follows:

> "**3.2.** …. It was clarified by the Ld. Counsel that the original agreements with the financial institutions provided for conversion of 20% of the amount in default into equity capital of the appellant at the option of the lenders. The agreements also provided for the repayment of the principal and the interest, in default as per the revised terms and conditions stipulated by the lendor at the time of default. As the appellant was not in position to pay the interest and liquidated damages. It approached the lead Financial Institutions which on behalf of all the institutions approved the Rehabilitation Plan According to the Rehabilitation Plan, the appellant issued 300149 convertible debentures of 100 each amounting to Rs. 3,00,14,900/ in lieu of outstanding interest and other charges. As a result of these debentures in favour of the Financial institutions, interest of Rs. 2,84,71,384/- was effectively paid. It was argued by the Ld. Counsel that liquidation of the outstanding interest by issue of debentures was tantamount to actual payment of interest as envisaged u/s 43B of the I.T. Act. It was emphasized by the Ld. Counsel that section 43B of the I.T. Act, cash or cheque is the

prescribed mode of payment of P.F. and ESI while there is no prescribed mode of payment of interest. The mode of payment of interest can therefore be other than cash or cheque/draft. The issue of debentures in lieu of interest therefore amounted to payment which had been acknowledged by the lead institutions. Since the lendor had admitted receipt of interest, there was no dispute about the payment.

….

However, the original terms and conditions of the borrowings not only provided for conversion of 20% of the amount in default into appellant's equity but also revision of terms and conditions of payment at the time of each default. The partial conversion into equity was at the option of the lendor which the lendor did not exercise. On the appellant's request, the lead institution acting as trustee of all the lenders agreed to the Rehabilitation Plan and accepted 300149 debentures of Rs. 100 each aggregating to Rs. 3,00,14,900/- in discharge of the outstanding interest. The discharge of the liability of interest through issue of debentures as mutually agreed between the appellant and the lenders was therefore in accordance with the terms and conditions governing the borrowings."

4. On these facts, the conclusion drawn by the learned CIT was:

"**3.6.** It would not be correct to say that a debenture is a piece of paper and the issue of debentures in lieu of interest merely postponed the payment of liability. A debenture is a valuable security which is freely negotiable and openly quoted in the stock market. As the Financial institutions had accepted the debentures in effective discharge of the liability for the outstanding interest which was no longer payable by the appellant, it was tantamount to actual payment for the intent of section 43B of the I.T. Act. As interest had been actually paid during the year and the payment was in accordance with

the terms and conditions of the borrowings, interest of Rs. 2,84,71,384/- is directed to be allowed u/s 43B of the I.T. Act."

5. This order was upheld in appeal by the Income Tax Appellate Tribunal ["**ITAT**"]. The ITAT held:

> "**9.** … The Section was introduced to curb the mischief of withholding tax payment by the assessee, while at the same time claiming deduction thereof in the income-tax assessments. But when both the parties creditor and debtor agree that the conversion of the outstanding interest liability into fully paid debentures would be accepted by them as discharge of the liability then to hold that notwithstanding the contract between the two, it is open to the income tax authorities to say that the interest liability has not been discharged would not only be opposed to the contextual perspective of section 43B, but would also do violence to the language used. In Subhra Motel Pvt. Ltd. (supra), the Delhi Bench of the Tribunal referred to the fact that the expression "actually paid" appearing in Section 43B is not qualified by words to the effect that the payment should be by cash or by cheque or draft or by any other mode as has been prescribed in the Second Proviso, with reference to clause (b) of the section which refers to the sum payable by the assessee as contribution to provident fund, superannuation fund, gratuity fund etc."

6. It then arrived at the important finding based on facts as follows:

> "**11.** … At page 197, the copy of the statement of taxable income of the assessee for the AY 2001-02 has been filed, which shows that in the year in which the debentures were redeemed, the assessee did not claim any deduction for the interest. It has thus been proved in the present case that the payment of interest by conversion of the outstanding liability into convertible debentures, is a real substantial and effective payment, meeting the requirement of the word "actual" and is

not a fictional or illusory payment. The parties have understood it as an effective discharge by the assessee of the interest liability. The treatment given in the accounts as well as in their income tax assessments is in accord with the factual position.

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12. … In the present case, the parties have agreed between themselves that the interest would be funded and convertible debentures would be issued in an amount identical to the funded interest and that this arrangement would be accepted by both of them as actual discharge of the liability to pay interest. In our opinion, nobody has the right to intervene and rewrite the arrangement for the parties and say that the parties cannot agree between themselves that this will be taken as actual discharge of the liability to pay interest. The apprehension expressed by the legislature while introducing the provisions of section 43B was that the assessee were not discharging their income tax liabilities by paying them and in fact, some of them were even obtaining a stay from the Courts and at the same time claiming such liability as deductions in their income tax assessments. This apprehension, which was the rationale behind Section 43B when it was introduced in 1984, appears to us to be misplaced in the present case. As already pointed out, herein we are not concerned with a statutory liability. The assessee is not claiming a deduction in the income tax assessment without actually clearing the statutory liability as had happened in the case of CIT vs: Udaipur. Distillery Co. Ltd. (No. 1) (268 ITR 305) before the Rajasthan High Court in that case there was a statutory liability to pay the duty to the Govt., and it was held that a bank guarantee would not meet the requirements of the section, and money has to actually flow into the illegible. In the case before us, it is a contractual liability where both the parties agree that the outstanding interest liability would be discharged by the assessee in a particular mode and that mode is followed. The assessee has

not claimed the interest as a deduction again in the year in which the debentures were redeemed and evidence to this effect has already been adverted to. The interest which is now allowed as a deduction in the assessee's assessment is reflected in the assessment of ICICI as its business income. Nobody is put to any loss. To invoke the provisions of section 43B, on the imaginary ground that there is no actual payment of the interest, would be wholly misplaced and would amount to a strained interpretation of the section."

7. Against the aforesaid judgment of the ITAT, the Revenue filed an appeal before the High Court, in which the question raised before the High Court for determination was set out as follows:

> "Whether the funding of the interest amount by way of a term loan amounts to actual payment as contemplated by Section 43B of the Income-tax Act, 1961?"

8. After correctly recording the facts that "the assessee was unable to discharge this interest liability due to its financial hardship. On 30/03/1994, the ICICI, by a letter waived a part of the compound interest together with the commitment charges and agreed to accept 3,00,149 convertible debentures of '100 each, amounting to 3,00,14,900/- in lieu of the outstanding amount", the Delhi High Court set out the reasoning of the ITAT in some detail and then the arguments of counsel for the Appellant and Respondent. In para 8, the judgment then set out Section 43B with Explanation 3C, which was inserted by the Finance Act, 2006

retrospectively w.e.f. 1.4.1989. The High Court concluded, based on Explanation 3C, as follows:

> **"10.** Now, Explanation 3C, having retrospective effect with effect from 01.04.1989, would be applicable to the present case, as it relates to AY1996-97. Explanation 3C squarely covers the issue raised in this appeal, as it negates the assessee's contention that interest which has been converted into loan is deemed to be "actually paid". In light of the insertion of this explanation, which, as mentioned earlier, was not present at the time the impugned order was passed, the assessee cannot claim deduction under Section 43B of the Act."

9. It then concluded, after referring to the judgments of the High Court of Madhya Pradesh and the High Court of Telangana and Andhra Pradesh, as follows:

> "**12.** In light of the introduction of Explanation 3C, this Court does not consider it necessary to discuss the precedents relied upon by the assesse delivered prior to the enactment of Finance Act, 2006. As regards the decision in Shakti Spring Industries [(2013) 219 Taxman 124], the interest due in that case was offset against a subsidy which the assessee was entitled to, and it did not involve an instance where was "converted into a loan or borrowing" within the meaning Explanation 3C. It is perhaps for this reason that Explanation 3 was not discussed."

10. On 22nd July, 2016, the High Court dismissed the Review Petition filed by the assessee stating as follows:

> "**8.** … The clear purport of the statute i.e. Section 43-B (d) is that any amount payable towards interest liability would

qualify for deduction; however Explanation 3C acts to insist on a rider:

> "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 shall not be deemed to have been actually paid."

Quite possibly the assessee's arguments would have been convincing and the court might have been persuaded that actual payment of amounts is inessential and a composition of the kind involved in this case, would have sufficed - but for Explanation 3C. Now, this provision was inserted with retrospective effect and clearly operated for the period in question. The assessee does not dispute that. Furthermore, this court's judgment cited the rulings of other courts- Andhra Pradesh & Telangana and the Madhya Pradesh High Courts- which held that actual payment is the sine qua non for applicability of Section 43-B. In the circumstances, the decisions in Standard Chartered [2006 (6) SCC 94] and Sunrise Associates [2006 (5) SCC 603], which declared the nature and character of debentures, are of little avail."

11. Shri Biswajit Bhattacharya, learned Senior Advocate appearing on behalf of the Appellant, first drew this Court's attention to an order dated 20th April, 2005 by which the question of law framed for consideration in the appeal before the High Court was as follows:

> "Whether the funding of the interest amount by way of a term 'debenture' amounts to actual payment as contemplated by Section 43B of the Income Tax Act, 1961?"

12. This question was then wrongly recorded as follows:

> "Whether the funding of the interest amount by way of a term loan amounts to actual payment as contemplated by Section 43B of the Income-tax Act, 1961?"

13. Since the High Court asked itself the wrong question, it reached the wrong conclusion as the key word "debenture" was missing in the question framed in the impugned judgment dated 18th May, 2015. He then took us through the facts that were found by the CIT and the ITAT and argued that, on facts, a finding was rendered in his favour that the debentures that were issued were not towards any future payment of liability, but towards actual payment of interest that was due and owed to the financial institution in question. He was at pains to point out that Explanation 3C, which was introduced with retrospective effect after these judgments, would have no application in the facts of this case as interest had not been converted into any loan or borrowing. Thus, both High Court judgments based exclusively on Explanation 3C are erroneous as they have ignored the vital facts found by the authorities below, which authorities are final on facts. To buttress his arguments, he also relied upon judgments showing that debentures are actionable claims and can be sold in the market as such.

14. Shri Bhattacharya also relied upon ***Cape Brandy Syndicate v. Inland Revenue Commissioner*** **[1921 (1) KB 64]** to submit that fiscal and tax statutes have to be strictly construed and that since the word "debenture" is not specified in Explanation 3C, it cannot be read into it.

15. Shri Balbir Singh, learned Additional Solicitor General, argued that Section 43B makes a departure from other Sections in the Act, as indicated by its non-obstante clause. The Section was introduced so that no deductions could be claimed based on a mercantile system of accounting as actual payment would have to be made. He also relied upon a judgment of this Court as to the correct meaning of "debentures" and then referred to and relied upon ***CIT v. Gujarat Cypromet Ltd.,*** **(2020) 15 SCC 460**, which referred to the impugned judgment in the present case with approval. He also argued that it being clear that a debenture is nothing but a loan, interest had, in fact, been converted into a loan on the facts of this case and squarely attracted the latter part of Explanation 3C.

16. At this juncture, it is important to set out Section 43B. The relevant provisions of the said Section read as follows:

43B. Certain deductions to be only on actual payment –

Notwithstanding anything contained in any other provision of this Act, a deduction otherwise allowable under this Act in respect of—

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(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

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shall be allowed (irrespective of the previous year in which the liability to pay such sum was incurred by the assessee according to the method of accounting regularly employed by him) only in computing the income referred to in section 28 of that previous year in which such sum is actually paid by him:

Provided that nothing contained in this section 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.

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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 shall not be deemed to have been actually paid.

17. Section 43B was originally inserted by the Finance Act, 1983 w.e.f. 1st April, 1984. The scope and effect of the newly inserted provision, at that point, was explained by the Central Board of Direct Taxes ["**Board**"] in Circular No.372/1983 dated 8th December, 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.
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> **35.3** To curb this practice, the Finance Act has inserted a new section 43B 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.
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> **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 the 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 43B 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 the 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 the 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 3C w.e.f. 1st April, 1989. The scope and effect of this provision was explained by the Board in Circular No.14/2006 dated 23rd December, 2006, as follows:

> **"16.2** It has come to notice that certain assessees were claiming deduction under section 43B 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 43B. A new Explanation 3C 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 43B, is converted into a loan or borrowing, the interest so converted, shall not be deemed to be actual payment.
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> **16.3** This amendment takes effect retrospectively from 1st April, 1989 *i.e.* the date from which clause (*d*) was inserted in section 43B and applies in relation to the assessment year 1989-90 and subsequent years."

19. The object of Section 43B, 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 43B(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. 1st April, 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 (*va*) 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 the CIT and the 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 institution 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 3C, 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 3C, at the heart of the introduction of Explanation 3C is misuse of the provisions of Section 43B 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 43B was found as a matter of fact by either the CIT or the ITAT. Explanation 3C, which was meant to plug a loophole, cannot therefore be brought to the aid of Revenue on the facts of this case. Indeed, if there be any ambiguity in the retrospectively added Explanation 3C, at least three well established canons of interpretation come to the rescue of the assessee in this case. First, since Explanation 3C was added in 2006 with the object of plugging a loophole – i.e. misusing Section 43B 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,*** **(1981) 4 SCC 173**, this Court construed Section 52 of the Income Tax Act as applying only to cases where 'understatement' is 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:

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 per cent 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 per cent 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. ….

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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 per cent 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.

22. Second, a retrospective provision in a tax act which is "for the removal of doubts" cannot be presumed to be retrospective, even where such language is used, if it alters or changes the law as it earlier stood. This was stated in ***Sedco Forex International Drill. Inc. v. CIT*, (2005) 12 SCC 717** as follows:

17. As was affirmed by this Court in Goslino Mario [(2000) 10 SCC 165] a cardinal principle of the tax law is that the law to be applied is that which is in force in the relevant assessment year unless otherwise provided expressly or by necessary implication. (See also Reliance Jute and Industries Ltd. v. CIT [(1980) 1 SCC 139] .) An Explanation to a statutory provision may fulfil the purpose of clearing up an ambiguity in the main provision or an Explanation can add to and widen the scope of the main section [See Sonia Bhatia v. State of U.P., (1981) 2 SCC 585, 598] . If it is in its nature clarificatory then the Explanation must be read into the main provision with effect from the time that the main provision came into force [See Shyam Sunder v. Ram Kumar, (2001) 8 SCC 24 (para 44); Brij Mohan Das Laxman Das v. CIT, (1997) 1 SCC 352, 354; CIT v. Podar Cement (P) Ltd., (1997) 5 SCC 482, 506]. But if it changes the law it is not presumed to be retrospective, irrespective of the fact that the phrases used are "it is declared" or "for the removal of doubts".

18. There was and is no ambiguity in the main provision of Section 9(1)(ii). It includes salaries in the total income of an assessee if the assessee has earned it in India. The word "earned" had been judicially defined in S.G. Pgnatale [(1980) 124 ITR 391 (Guj)] by the High Court of Gujarat, in our view, correctly, to mean as income "arising or accruing in India". The amendment to the section by way of an Explanation in 1983 effected a change in the scope of that judicial definition so as to include with effect from 1979, "income payable for service rendered in India".

19. When the Explanation seeks to give an artificial meaning to "earned in India" and brings about a change effectively in the existing law and in addition is stated to come into force with effect from a future date, there is no principle of interpretation which would justify reading the Explanation as operating retrospectively.

23. This being the case, Explanation 3C is clarificatory – it explains Section 43B(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*** (supra) as followed by judgments of this Court – See ***Vodafone International Holdings BV v. Union of India,*** **(2012) 6 SCC 613** at paras 60 to 70 per Kapadia, C.J. and para 333, 334 per Radhakrishnan, J.

25. The High Court judgment dated 18th May, 2015, is clearly in error in concluding that 'interest', on the facts of this case, has been converted into a loan. There is no basis for this finding - as a matter of fact, it is directly contrary to the finding on facts of the authorities below.

26. The learned ASG's reliance on ***National Rayon Corpn. Ltd. v. CIT,*** **(1997) 7 SCC 56** is disingenuous. That was a decision which turned on whether a sum of Rs.79 lakhs represents 'Debenture Redemption Reserve' and was includible in computing the capital of the assessee company for the purpose of the Companies (Profits) Surtax Act, 1964. The High Court took the view that the amount set apart to redeem

debentures had to be treated as a “provision” and not as a “reserve”. While discussing this question, this Court held :

> **8.** Mr Ramachandran advanced another argument that there was no present liability to pay any amount to the debenture-holders. That liability will arise only when the amount falls due for payment. Therefore, there was no existing liability for redeeming the debentures in the relevant year of account.
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> **9.** We are unable to uphold this argument. The liability to repay arises the moment the money is borrowed. The amount borrowed may be repayable immediately or in future. The date of repayment of loan may be deferred by agreement but the obligation or the liability to repay will not cease on that account. The obligation is a present obligation; *debitum in praesenti, solvendum in futuro*. This aspect of the matter was explained in the judgment of this Court in *Kesoram Industries and Cotton Mills Ltd.* v. *CWT* [AIR 1966 SC 1370 : (1966) 59 ITR 767] .
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> **10.** By issuing the debentures, the Company had taken a loan against the security of its assets. This loan may not be repayable in the year of account. But the obligation to pay the loan is a present obligation. Any money set apart in the accounts of the Company to redeem the debentures must be treated as moneys set apart to meet a known liability. The debentures will have to be shown in the Company's balance sheet of the year as “liability”.
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> **11.** In the case of *CIT* v. *Peico Electronics & Electricals* [(1987) 166 ITR 299 (Cal)] the Calcutta High Court held that the Debenture Redemption Reserve will have to be treated as a “reserve” and not “provision” because, none of the debentures became redeemable during the accounting period. The liability to redeem the debenture was a future liability. The debentures had been separately shown in the balance sheet as a liability. The reserve had been created by

appropriation of profits and not by way of a charge on revenue.

12. We are of the view that this approach is erroneous and overlooks the definitions of “provision” and “reserve” given in the Companies Act. The debentures were nothing but secured loans. Merely because the debentures were not redeemable during the accounting period, the liability to redeem the debentures did not cease to exist. It was redeemable or repayable at a future date. But it was a known liability. In the form of balance sheet prescribed by the Act in Schedule VI, the secured loans have to be shown under the heading “liabilities”. Secured loans include (1) debentures, (2) loans and advances from banks, (3) loans and advances from subsidiaries and (4) other loans and advances. The secured loans might not be immediately repayable, but the liability to repay these loans was an existing liability and has to be shown in the Company's balance sheet for the relevant year of account as a liability. Amounts set apart to pay these loans cannot be “reserve”. The interpretation clause of the balance sheet in Schedule VI of the Companies Act specifically lays down that reserves shall not include any amount written off or retained by way of providing for a known liability.

27. The question decided in this case is far removed from the question to be decided in the facts of the present case and has no application to these facts whatsoever. The question in the present case does not depend upon what can, in law, be stated to be a debenture and/or whether it is convertible or non-convertible or payable immediately or in the future. The question in the present case is only whether interest can be said to have been actually paid by the mode of issuing debentures.

To answer this question, this judgment has no relevance.

28. The learned ASG then relied upon a recent judgment of this Court in ***CIT v. Gujarat Cypromet Ltd.*** (supra). In the said case, a Division Bench of this Court, while dealing with Section 43B Explanation 3C, noted the facts as found by the CIT as follows (para 5):

> "2.2. I have perused the case laws cited and also the above sanction letter from IDBI and also the auditor's note referred by the assessing officer. I have perused Schedule 3 of the balance sheet as on 31-3-2001 and find that the above loan appears as on 31-3-2001 and is part of the total secured loans of Rs 75,26,10,769. The fact that the entry pertaining to the interest element outstanding to financial institutions referred at page 2 of the order by the assessing officer has been reversed after receipt of funds of Rs 8 crores from IDBI substantiates the contention of the appellant company that the entries relating to interest outstanding with reference the above institutions have been squared up and its place a new credit entry of loan of IDBI is now appearing in the balance sheet as on 31-3-2001. The plea of the appellant's counsel Shri Tanna that since no interest payment is outstanding now and the amount is paid off, the expenditure of interest is allowable under Section 43-B. It is further added that in case the loan had been disbursed in 2 parts — one to meet the interest outstanding and the balance for financial assistance still the entries in the books of account would have remain the same and the outstanding interest would have been NIL. Having regard to the above facts and also the case laws cited by the appellant's representative, I am inclined to hold that the disallowance made by the assessing officer is contrary to the substance of the transaction and the provisions of Section 43-B of the Income Tax Act and the same cannot be sustained and therefore directed to be deleted."

29. It is on these facts that Explanation 3C was pressed into service in favour of Revenue and paras 11 and 12 of the impugned judgment in the present case were referred to, in passing, in para 13. Ultimately, this Court concluded:

> **16.** In the impugned judgment [*CIT v. Gujarat Cypromet Ltd.,* 2006 SCC OnLine Guj 560], the Gujarat High Court has relied upon *CIT v. Bhagwati Autocast Ltd.,* 2002 SCC OnLine Guj 381 which was not a case covered by Section 43-B(d) rather was a case of Section 43-B(a). The provision of Section 43-B covers a host of different situations. The statutory Explanation 3-C 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 3-C, we are, thus, of the view that the assessing officer has rightly disallowed the deduction as claimed by the assessee. The appellate authority, ITAT and the High Court erred in reversing the said disallowance.

30. On the facts of that case, this Court found that Explanation 3C was squarely attracted in that outstanding interest had not actually been paid, but instead a new credit entry of loan now appeared, bringing the case within the express language of Explanation 3C. This is far removed from the facts of the present case, which were not adverted to at all in this judgment. Consequently, this judgment is also distinguishable and would not apply to govern the facts of the present case.

31. Consequently, the impugned judgments of the High Court are set aside and the judgment and order of the ITAT is restored. These appeals are allowed in the aforesaid terms.

…….....J.
[ROHINTON FALI NARIMAN]

…….....J.
[B.R. GAVAI]

New Delhi;
August 11, 2021.