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Tax alert: Payment for purchase of loan, which includes accrued interest, not liable to TDS

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The Mumbai Bench of the Income-tax Appellate Tribunal has held that payment made for acquisition of loan book at book value, comprising of principle value and accrued interest, would not attract withholding tax provisions under section 193/194A of the Income-tax Act, 1961 (ITA), in the absence of moneys borrowed as well as absence of lender-borrower relationship between the two parties.

In a nutshell

If the provisions of sections 193/194A of the ITA were already triggered and complied with, at the time of credit of interest income to the account of seller company in the books of the borrowers [i.e. the person responsible for payment of such interest income], it would not be triggered again on payment of the same interest by the taxpayer (buyer company) to the seller company.

To trigger section 2(28A) of the ITA, the existence of 'moneys borrowed or debt incurred' is necessary. In absence of same, payment made by the taxpayer cannot be subjected to TDS under section 194A of the ITA.
In absence of any statutory/contractual obligation on the part of taxpayer to discharge the borrowers obligation to make payment towards interest/accrued interest, the taxpayer cannot be regarded as a person responsible for paying income by way of interest/interest on securities under sections 193/194A of the ITA.

The nature of income in the hands of the recipient and the nature of expenditure of the said sum in the hands of the payer need not be the same.

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Background:

- The taxpayer[1] is a non-deposit taking non-banking finance company (NBFC) registered with the Reserve Bank of India (RBI) and engaged, *inter-alia*, in the business of lending.
- During the financial year (FY) under consideration, the taxpayer purchased from its related entity (A Co), Non-Convertible Debentures (NCDs), Inter-Corporate Deposits (ICDs) and Term Loans portfolio.
- The Revenue authorities, during a survey under the provisions of the Income-tax Act, 1961 (ITA) discovered that during the FY under consideration the taxpayer had credited interest income to its Profit and Loss account in relation to NCDs, ICDs and Term Loans portfolio purchased from A Co on which tax had not been deducted at source.
- The Assessing Officer (AO) noted that the NCDs, ICDs and Term loans were purchased from A Co at carrying value comprising of principle value and accrued interest. According to the AO, the payment made by the taxpayer to A Co in excess of the principle value, constituted income liable to tax in the hands of A Co, in the nature of 'Interest other than Interest on Securities' and 'Interest on Securities'. Therefore, the taxpayer was under obligation to withhold tax (TDS) in respect of the same under sections 193 and 194A of the ITA [relating to TDS on certain interest payments].
- The taxpayer argued that it was not liable to deduct tax on the payments made to A Co on the following basis:
  - Payment to A Co was for acquiring 'right to receive' the principle along with interest from the debtors/borrowers on maturity. The consideration was paid for purchase of an asset being 'right to receive' and the same cannot be termed as interest paid to A Co.
  - The payment to A Co did not fall within the definition of term 'interest' under section 2(28A) of the ITA (relating to definition of interest). The definition of 'interest' necessarily required payment in respect of 'money borrowed or debt incurred'. In the case under consideration, the relationship of borrowers and lenders did not exist between the taxpayer and A Co. Therefore, payment made to A Co did not qualify as 'interest on securities'.
  - TDS provisions were not attracted since no income had accrued to A Co as a result of transfer of NCDs/ICDs/Term Loans as the same were transferred to the taxpayer at book value and the consideration paid to A Co was equal to the carrying value as standing in the books of accounts of A Co.
  - The accrued interest had been recorded in the books of accounts of A Co. Further, the borrowers had deducted TDS from such interest income and had deposited the TDS with the government treasury as per the provisions of the ITA.
  - A Co had accounted for the purchase price given by the taxpayer to A Co in its books of accounts and had taken the same into consideration while offering to tax income for the year under consideration. Therefore, no part of tax required to deduct TDS could be recovered from the taxpayer in view of the provisions of section 201(1) of the ITA.
- However, the AO concluded that taxpayer had failed to discharge the obligation to deduct tax from the payments made to A Co in excess of the principle value under the provisions contained in sections 193 and 194A of the ITA, thereby treated the taxpayer as 'assessee in default' and raised demand vide order under section 201(1)/201(1A) of the ITA.
- Aggrieved, the taxpayer filed an appeal before Commissioner of Income-tax (Appeals) [CIT(A)]. The CIT(A) agreed with the AO and concluded that A Co had accounted for broken period interest as its income.

[1] Piramal Capital and Housing Finance Ltd vs ACIT, TDS 1(1)(1) [2024] ITA No. 2351/Mum/2024 (Mumbai-Trib.)

Therefore, the contention of the taxpayer that payment made by the taxpayer to A Co was not in the nature of interest income could not be accepted.

The CIT(A) after relying on an earlier ruling[2] of the Bombay High Court - wherein it was held that broken period interest should be treated as revenue expenditure - concluded that the amount paid by the taxpayer towards accrued interest to A Co, was in the nature of income liable to deduction of tax at source under sections 193 and 194A of the ITA. However, the CIT(A) granted partial relief to the taxpayer that in case A Co had offered to tax the entire payment received from the taxpayer towards accrued interest income, no recoveries could be made from the taxpayer on account of failure of the taxpayer to deduct tax from such payments in view of the provisions contained under section 201(1A) of the ITA [relating to consequences for not depositing TDS with the government].

- Aggrieved, the taxpayer filed an appeal against the CIT(A)'s order before the Mumbai Bench of the Income-tax Appellate Tribunal (ITAT).

Relevant provisions in brief:

Extracts of sections 2(28A), 193 and 194A of the ITA:

Section 2(28A):

"interest" means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilised;"

"Interest on securities.

193. *The person responsible for paying to a resident any income by way of interest on securities shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax at the rates in force on the amount of the interest payable……..."*

Interest other than "Interest on securities.

194A. *(1) Any person, not being an individual or a Hindu undivided family, who is responsible for paying to a resident any income by way of interest other than income by way of interest on securities, shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rates in force……"*

Decision of the ITAT:

The ITAT noted / observed as follows:

Provisions of sections 193/194A cannot be applied twice:

- As per sections 193 and 194A of the ITA, any person responsible for paying any income by way of 'interest on securities' or 'interest other than interest on securities' is under obligation to deduct income tax from the same (a) at the time of credit of such income to the account of the payee, or (b) at the time of payment thereof, whichever is earlier. Thus, the obligation to withhold tax gets fastened on credit or payment, whichever is earlier.
- In the case under consideration, accrued interest had been recorded in the books of accounts of A Co. The contention of the taxpayer that borrowers had deducted TDS from such interest income *[at the time of credit*

[2] American Express International Banking Corpn. Vs. CIT [2002] 258 ITR 601 (Bom HC)

of such income in the account of A Co in their respective books of accounts] and had deposited the tax so deducted with the government treasury as per provisions of the ITA was not controverted by the Revenue.

- Therefore, the provisions of sections 193/194A of the ITA having already been triggered and complied with at the time of credit of interest income to the account of A Co in the books of accounts of the borrowers [i.e. the person responsible for making payment of such interest income at the relevant time], could not again get triggered on payment of the same interest income by the taxpayer to A Co.
- Therefore, the provisions contained in sections 193/194A of the ITA were not attracted and therefore, the question of taxpayer committing default in complying with the provisions of these sections did not arise.

No lender-borrower relationship between taxpayer and A Co

- When the interest income had accrued to A Co, there existed lender-borrower relationship between A Co and the borrowers. Subsequently, the taxpayer stepped into the shoes of A Co and as a result, lender-borrower relationship between the taxpayer and the borrowers came into existence.
- The borrowers continued to be under contractual obligation to make payment of interest/accrued interest while the taxpayer acquired the 'right to receive' the same.
- There was no dispute that no lender-borrower relationship existed between the taxpayer and A Co at any point in time. Therefore, in absence of any statutory/contractual obligation on the part of taxpayer to discharge the borrower's obligation to make payment towards interest/accrued interest to A Co, the taxpayer could not be regarded as person responsible for paying income by way of interest/interest on securities to A Co under sections 193/194A of the ITA.

Reliance on earlier rulings

- In an earlier ruling[3], the Mumbai Bench of the ITAT held that to trigger section 2(28A) of the ITA, the existence of 'moneys borrowed or debt incurred' was necessary. In absence of 'moneys borrowed or debt incurred' the payment made by the taxpayer in that case could not have been subjected to TDS under section 194A of the ITA. Further, the nature of income in the hands of the recipient and the nature of expenditure of the said sum in the hands of the payer need not be the same.
- Similarly, in another earlier ruling[4] the Mumbai Bench of the ITAT had held that in the main limb of the definition of 'interest', interest should be in respect of the money-borrowed or debt-incurred. The interest is payable by the borrower who has borrowed the money from the lender or the debt is incurred by him in favour of the lender who has given the money is a key factor to bring the payment within the ambit of definition of 'interest' under section 2(28A) of the ITA.
- In view of the above, in absence of any moneys borrowed or debt incurred, payments made by the taxpayer to A Co in excess of the principle value of the ICDs/NCDs/Term Loans recorded in the books of accounts of A Co could not be regarded as 'interest'/'interest on securities' as defined under section 2(28A) of the ITA.

In view of the above, the ITAT agreed with the taxpayer's contentions and deleted the additions made by the AO on account of non-deduction of taxes.

Comments:

There often arise situations when a lender assigns the loans to another party. Broken period interest may have accrued on such loan, at the time of assignment and the consideration for assignment of loan may include such

[3] State Bank of India Vs. DCIT [2024] 163 taxmann.com 266 (Mum - Trib.)

[4] Idea Cellular Ltd. Vs. ADIT [2015] 172 TTJ 540 (Mum. Trib)

broken-period interest. A question in such cases arises whether the buyer of such loans would be required to deduct TDS on the broken-period interest.

The ITAT, in this ruling, has reiterated the following principles:

- If the provisions of sections 193/194A of the ITA were already triggered and complied with, at the time of credit of interest income to the account of seller company in the books of the borrowers [i.e. the person responsible for making payment of such interest income at the relevant time], it would not again get triggered on payment of the same interest income by the taxpayer (buyer company) to seller company.
- To trigger section 2(28A) of the ITA, the existence of 'moneys borrowed or debt incurred' is necessary. In absence of same, payment made by the taxpayer cannot be subjected to TDS under section 194A of the ITA.

  The interest is payable by the borrower who has borrowed the money from the lender or the debt is incurred by him in favour of the lender who has given the money is a key factor to bring the payment within the ambit of definition of 'interest' under section 2(28A) of the ITA.
- In absence of any statutory/contractual obligation on the part of taxpayer to discharge the borrowers obligation to make payment towards interest/accrued interest, the taxpayer cannot be regarded as person responsible for paying income by way of interest/interest on securities under sections 193/194A of the ITA.
- The nature of income in the hands of the recipient and the nature of expenditure of the said sum in the hands of the payer need not be the same.

The ITAT has also held that the Bombay High Court ruling[5] relied on by the CIT(A) did not apply to the facts of the case under consideration on the basis that the issue in the case pertained to the nature of payment made by the buyer of securities on account of broken-period-interest and not the treatment of such payment in the hands of the seller receiving the same.

Taxpayers with similar facts may want to evaluate the impact of this ruling to the specific facts of their cases.

[5] American Express International Banking Corpn. Vs. CIT [2002] 258 ITR 601 (Bom HC)

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