



Tax alert: OCDs, CCDs are 'bonds', interest eligible for concessional tax rate

2 September 2025

The Delhi Bench of the Income-tax Appellate Tribunal (ITAT) has held that Optionally Convertible Debentures (OCDs) and Compulsory Convertible Debentures (CCDs) are akin to 'bonds', and hence interest earned on such OCDs/CCDs would be eligible for concessional tax rate under section 194LD of the Income-tax Act, 1961 (ITA).

In a nutshell



'Debenture' and 'share' are separate and distinct instruments with separate rights and obligations of both the issuer company and the subscriber.

Debentures have inseverable relation with debt. An acknowledgement of indebtedness is inherent in it. The payment of interest pre-supposes the fact that money has been borrowed or a debt has been incurred.



The obligation to repay the amount is embedded in the concept of debt, the repayment need not be in the form of cash, it could be in kind. Conversion of bonds into fully paid-up equity shares at the end of the specified period at the conversion price amounts to constructive repayment of debt.



The only uncertainty in OCDs is whether the debenture holder will go for conversion into shares or will continue to hold them as debentures. This uncertainty in no way impacts the inherent nature of the instrument.

The nature, rights and obligations attached to OCDs / CCDs, cannot be equated with that of shares until conversion thereof; till then OCDs / CCDs retain the character of a debenture simpliciter.



Scroll down to read the detailed alert

Background:

- The taxpayer¹ is a foreign company and a tax resident of Singapore. It is a Category II Foreign Portfolio Investor (FPI) registered with the Securities and Exchange Board of India (SEBI).
- During the Financial Year (FY) 2019-20 corresponding to Assessment Year (AY) 2020-21, the taxpayer earned interest income and claimed to be eligible for a concessional tax rate of 5.46% (including applicable surcharge and cess) under section 115A(1)(a)(BA)(ii) read with section 194LD of the Income-tax Act 1961 (ITA) [relating to tax on certain interest income of non-resident FPIs].
- The aforesaid interest was earned by the taxpayer on investments made in debt instruments i.e., Non-Convertible Debentures (NCDs), Compulsory Convertible Debenture (CCDs) and Optionally Convertible Debenture (OCDs).
- During the course of the audit proceedings, the Assessing Officer (AO) denied the concessional tax rate benefit on the premise that section 194LD of the ITA provides a lower tax rate only in the context of Rupee denominated 'bonds' and not Rupee denominated 'debentures'.
- Aggrieved, the taxpayer filed its objections before the Dispute Resolution Panel (DRP), wherein the DRP allowed the concessional tax rate of 5.46% of the ITA on the NCDs based on an earlier letter² circulated within the Income-tax department.
- Pursuant to above directions, the AO passed the final assessment order restricting the benefit of the concessional rate tax under section 194LD of the ITA only to NCDs but did not grant the benefit of such concessional tax rate for the interest earned on OCDs and CCDs.
- Aggrieved, the taxpayer filed an appeal with the Delhi Bench of the Income-tax Appellate Tribunal (ITAT).

Relevant provisions in brief:

- **Relevant extract of section 194LD of the ITA:**

"Income by way of interest on certain bonds and Government securities.

(1) Any person who is responsible for paying to a person being a Foreign Institutional Investor or a Qualified Foreign Investor, any income by way of interest referred to in sub-section (2), shall, at the time of credit of such income to the account of the payee or at the time of payment of such income in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rate of five per cent.

(2) The income by way of interest referred to in sub-section (1) shall be the interest payable,—

(a) on or after the 1st day of June, 2013 but before the 1st day of July, 2023 in respect of the investment made by the payee in—

- (i) a rupee denominated bond of an Indian company; or***
- (ii) a Government security;....."***

Decision of the ITAT:

The ITAT noted/ held as follows:

- The ITAT noted that with respect to NCDs there was no dispute that NCDs are considered as 'Bonds' for the

¹ Amplus Energy Solutions Pte Ltd. vs. ACIT, international tax 1(1)(1), New Delhi [2025] 175 taxmann.com 1070 (Delhi-Trib.)

² Internal letter dated 30 November 2017 issued by the PCCIT, International tax in the context of section 194LD of the ITA to CCIT/CIT under International Tax jurisdiction

purposes of section 194LD of the ITA.

- On perusal of section 194LD of the ITA, the following conditions need to be satisfied for the applicability of concessional tax rate of 5.46% (including applicable surcharge and cess):
 - Condition 1: Interest is paid/payable to FIIs or QFIIs;
 - Condition 2: Interest is payable within 1 June 2013 up to 1 July 2020 (extended up to 1 July 2023);
 - Condition 3: Interest is payable on securities specified in the section i.e. Rupee Denominated Bond (RDB) of an Indian company or Government security;
 - Condition 4: Rate of interest in respect of RDB of an Indian company should not exceed the interest rate notified by the Central Government.

With respect to OCDs and NCDs while the other conditions were satisfied, the only issue under consideration was whether CCDs and OCDs fall in the category of RDB of an Indian company and thus, the provisions of section 194LD of the ITA apply.

- ‘Debenture’ and ‘share’ are separate and distinct instruments with separate rights and obligations of both the issuer company and the subscriber.

For instance, the instrument of debenture is evidence of existence of debt with the issuing company. Unlike, debentures, instruments in the nature of shares (be it equity or preference) are not in the nature of debt, but form part of the permanent capital of the company, entitling the holder to certain preferential rights, like voting rights, dividend, etc.

- In an earlier ruling, the Supreme Court³, after detailed analysis of the difference between debenture and shares, noted that ‘share’ has been defined in the Companies Act, 1956 to mean share in the share capital of a company, while debenture is simply an instrument of debt executed by the company acknowledging its liability to repay the amount represented therein at a specified rate of interest. In other words, debenture is a certificate of loan or bond evidencing the fact that the company is liable to pay an amount specified with interest. Though the amount which is raised by a company through debentures becomes part of its capital structure, the same does not become part of share capital.
- Further, in other rulings⁴, the Courts and Benches of the ITAT had recognized the difference between CCDs / OCDs and shares, to hold that expenses incurred on issuance of CCDs / OCDs being debt instruments, which are different from shares, were allowable deduction under the provisions of the ITA.

Based on the same, it could be concluded that debentures have inseparable relation with debt. An acknowledgement of indebtedness is inherent in it. The payment of interest pre-supposes the fact that money has been borrowed or a debt has been incurred.

The obligation to repay the amount is embedded in the concept of debt, the repayment need not be in the form of cash; it could be in kind. Conversion of bonds into fully paid-up equity shares at the end of the specified period at the conversion price amounts to constructive repayment of debt.

The rights and obligation of debentures, in general, would *mutatis mutandis* be applicable to the OCDs / CCDs prior to their conversion.

The only uncertainty in the OCDs is whether the debenture holder will opt for conversion into shares or will continue to hold them as debentures. This uncertainty in no way impacts the inherent nature of the instrument. The nature, rights and obligations attached to OCDs / CCDs, cannot be equated with that of shares until conversion thereof; till then OCDs / CCDs retain the character of a debenture simpliciter.

³ R.D. Goyal v. Reliance Industries Ltd. [113 Comp. Cas. 1/ 40 SCL 503]

⁴ Sahara India Real Estate Corporation Limited and Ors v. Securities Exchange Board of India (Civil appeal no 9833 of 2011) Authority for Advance Ruling (Income Tax) 307 ITR 40 (LMN India Ltd) and DCIT vs. UAG Builders (P) Ltd.: 53 SOT 370

- For section 194LD of the ITA, the security should be Rupee denominated. The intention here being that an Indian company does not bear any risk of foreign exchange fluctuation at the time of repayment of the principal or the interest amount. The distinction between OCD/CCD with NCD is of no consequence and they are debt instruments only like bonds.
- A bond, as a security, when distinguished from debentures is for the purpose of signifying that bonds may at times be backed up by some collateral security, while the same is not the case of debentures. To treat CCDs and OCDs as shares *in praesentia* would be extending the principles of interpretation too far; in fact the purposive interpretation would require extending the benefit to the taxpayer as long as the OCDs/CCDs are rupee denominated, when the investment is sought or interest is paid.

In view of the above, the ITAT held that tax authorities had erred in not giving the taxpayer the benefit of section 194LD in regard to OCDs/CCDs.

Comments:

The provisions of the ITA do not specifically define 'bonds' or 'debentures'. Hence the same could be a subject of interpretation (especially in case of OCDs or CCDs).

In this ruling, the ITAT, while granting the benefit of concessional tax rate under section 194LD of the ITA to OCDs and CCDs, has upheld the following principles:

- 'Debenture' and 'share' are separate and distinct instruments with separate rights and obligations of both the issuer company and the subscriber. Debentures have an inseverable relation with debt. An acknowledgement of indebtedness is inherent in it. The payment of interest pre-supposes the fact that money has been borrowed or a debt has been incurred.
- The obligation to repay the amount is embedded in the concept of debt. The repayment need not be in the form of cash; it could be in kind. Conversion of bonds into fully paid-up equity shares at the end of the specified period at the conversion price, amounts to constructive repayment of debt.
- The only uncertainty in OCDs is whether the debenture holder will opt for conversion into shares or will continue to hold them as debentures. This uncertainty does not impact the inherent nature of the instrument. The nature, rights and obligations attached to OCDs / CCDs, cannot be equated with that of shares until conversion thereof; till then OCDs / CCDs retain the character of a debenture simpliciter.

It is important to note that the provision of section 194LD of the ITA is applicable to interest payable on rupee denominated bonds before **1 July 2023**. This ruling may be relevant for other relevant provisions of the ITA such as section 194LC of the ITA.

Further, the classification of CCDs / OCDs as debt or equity has been a subject of litigation (for e.g. classification for deductibility of interest expense till conversion of CCDs / OCDs). This ruling may be relevant in such cases.

Taxpayers may evaluate the impact of this ruling to the specific facts of the case.

Deloitte.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited ("DTTL"), its global network of member firms, and their related entities (collectively, the "Deloitte organization"). DTTL (also referred to as "Deloitte Global") and each of its member firms and related entities are legally separate and independent entities, which cannot obligate or bind each other in respect of third parties. DTTL and each DTTL member firm and related entity is liable only for its own acts and omissions, and not those of each other. DTTL does not provide services to clients. Please see <http://www.deloitte.com/about> to learn more.

Deloitte Asia Pacific Limited is a company limited by guarantee and a member firm of DTTL. Members of Deloitte Asia Pacific Limited and their related entities, each of which is a separate and independent legal entity, provide services from more than 100 cities across the region, including Auckland, Bangkok, Beijing, Bengaluru, Hanoi, Hong Kong, Jakarta, Kuala Lumpur, Manila, Melbourne, Mumbai, New Delhi, Osaka, Seoul, Shanghai, Singapore, Sydney, Taipei and Tokyo.

This communication contains general information only, and none of DTTL, its global network of member firms or their related entities is, by means of this communication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser.

No representations, warranties or undertakings (express or implied) are given as to the accuracy or completeness of the information in this communication, and none of DTTL, its member firms, related entities, employees or agents shall be liable or responsible for any loss or damage whatsoever arising directly or indirectly in connection with any person relying on this communication.