



Tax Insights

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Interest earned on non-convertible debentures and bonds shall be treated as same for applying the beneficial tax rate of 5% as per section 194LD – Delhi bench of the Tribunal

In brief

The Delhi bench of the Income-tax Appellate Tribunal¹ (Tribunal) has held that a beneficial tax rate of 5% prescribed under section 194LD read with section 115(A)(1)(a)(iiab) of the Income-tax Act, 1961 (the Act) shall be available on interest income earned from investments made in rupee denominated non-convertible debentures (NCD).

In detail

Background

- The non-resident taxpayer invested in rupee denominated NCD of Indian companies and earned interest income thereon. The said interest income was offered to tax, applying the tax rate of 5% as per 194LD read with section 115A(1)(a)(iiab) of the Act.
- The Tax Officer (TO) held that section 194LD of the Act is applicable only when interest is earned on rupee denominated bonds. In the instant case, the taxpayer had earned interest on NCD. Hence, section 194LD of the Act will not be applicable and the taxpayer shall be liable to pay tax as per the rate mentioned in Article 11 of the India–Germany Double Taxation Avoidance Agreement, which is 10%.
- The DRP affirmed the order of the TO.

Issue before the Tribunal

- Should ‘debenture’ be considered as ‘bond’ for the purpose of section 194LD of the Act?

Tribunal’s ruling

- The issue is covered in favour of the taxpayer by the decision of the jurisdictional Delhi High Court² wherein, while discussing the issue on the specified modes of investment under section 11(5) of the Act,

¹ ITA No. 531/Del/2022

² DIT v. Shree Visheshwar Nath Memorial Public Ch. Trust [ITR 332 of 1991]

the court held that, in absence of a definition of the term 'debenture' under the Act, reliance may be placed upon the definition provided under the Companies Act 1956. As per the Companies Act 1956, 'bond' is covered under the expression 'debenture'.

- The exposition of the jurisdictional High Court on the term 'debenture' should prevail over the meaning provided by the Revenue.

The takeaways

The ruling provides relief to specified non-resident taxpayers from being charged at a higher rate of tax on interest earned on rupee denominated debentures.

The ruling follows the principles laid down by higher appellate authorities that, in the absence of the definition of the term given under the Act, meaning has to be derived from the definition provided under other regulations and also as understood in common parlance.

The proviso to section 194LD of the Act provides that the rate of interest on rupee denominated bond shall not exceed the rate notified by the Central Government. Applicability of the said proviso on NCDs remains unaddressed.

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