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Interest received for delay in completion of the process of buy-back of shares under open offer to be treated as capital gains and not interest income

In brief

Recently, in the case of Genesis Indian Investment Company Ltd[1], the Mumbai Income-tax Appellate Tribunal (Tribunal) held that the additional amount received by the assessee as interest for delay in completion of the process of buy-back of shares was a part of sale consideration and accordingly should be taxed as capital gains and not as interest income.

Facts

- The assessee, Genesis Indian Investment Company Ltd., a Mauritian company, was registered with Securities and Exchange Board of India (SEBI) as a sub-account of Genesis Asset Managers Ltd. (registered Foreign Institutional Investor). It held shares of Castrol India Ltd (a subsidiary of Castrol Ltd, UK).

- As a part of the global acquisition of Burmah Castrol Plc by British Petroleum through a press announcement on March 14, 2000, the consequential open offer was announced for acquisition of shares of Castrol India Ltd. British Petroleum approached SEBI for seeking exemption from the requirement of

[1] Genesis Indian Investment Company Ltd. *v.* CIT(A) [TS-405-ITAT-2013 (Mum)]

making a public offer, which SEBI disposed off on August 7, 2000 by granting exemption subject to certain conditions.

- As these conditions were not acceptable, on December 11, 2000, Castrol UK made an open offer for acquisition of shares of Castrol India at an offer price based on the market price as on July 7, 2000. Subsequently, SEBI directed Castrol UK to revise the offer price based on the market price as on March 14, 2000. This issue was litigated and in August 2001, the High Court confirmed the Securities Appellate Tribunal's (SAT) order and Castrol UK was directed to fix market price as on March 14, 2000 as the offer price.

- The High Court also upheld the SAT order directing interest to be paid on a successful offer @ 15% on the open offer price from August 8, 2000 until the actual date of payment of consideration.

- The assessee tendered 2.05 million shares under the open offer on October 17, 2001, out of which 1.04 million shares were accepted by Castrol UK on November 23, 2001. The assessee also received INR 70.77 million as interest @15% per annum for delay in payment of consideration.

- The CIT (A) confirmed the AO's order taxing INR 70.77 million as interest income, observing that it was consideration received for use of money after Castrol UK accepted the shares, and a debt was created in the assessee's favour.

Issue

- Is the sum received for delayed payment of consideration of buy-back proceeds taxable as interest income, or is it to be considered as part of sale consideration and taxed as capital gain?

Assessee's contentions

- Clause 5 of Article 11 of the India-Mauritius tax treaty defines interest as income from debt claims. Furthermore, it states that penalty charges for late payment shall not be regarded as interest income.

- The assessee contended that the additional sum received was not for any debt claim but was additional consideration towards shares tendered. There was no debtor-creditor relationship between the assessee and Castrol UK, and therefore the additional consideration was not taxable as interest income.

- The assessee also highlighted the fact that the additional sum was received in respect of the period before tender of shares. Furthermore, it was not certain that shares tendered by the assessee would be accepted by Castrol UK. Thus, there was no question of creating any debt in favour of the assessee prior to acceptance of shares tendered by the assessee.

Revenue's contentions

- The revenue authorities relied on decisions of the SAT and the High Court wherein Castrol UK was held liable to pay interest @ 15% on the offer price. The payment was termed as interest and not as penalty.

- The revenue contended that the additional sum had been paid because of deprivation of use of money and hence was in the nature of interest.

Tribunal's ruling

- The Tribunal observed that the additional sum paid was interest for failure to make the payment as per the schedule prescribed under SEBI regulations.

- There was a difference between interest that could be treated at par with consideration and interest that was different from compensation/ consideration; if interest was paid for delay in making the payment, it could not be treated as part of consideration.

- The delay for which the assessee received interest was delay in completing the process of buy-back of shares, and not for paying the determined consideration after the purchase/ sale transaction was over.

- Relying on the Supreme Court decision of CIT *v*. Govinda Choudhury and Sons[2], the Tribunal held that interest paid in respect of period before the date of acquisition of shares could not be said to be interest paid due to delay in payment of consideration. Thus, the additional amount received by the assessee was part of the sale consideration, and accordingly had to be treated capital gains and not as interest income.

Conclusion

The Tribunal held that the additional sum received was a part of sale consideration and not interest income. The deciding factor in this case was the fact that the interest was payable for delay in completing the buy-back process after the open offer was announced, and not for delayed payment of consideration. This decision reaffirms the principle that for any payment to be characterised as interest, the debtor-creditor relationship should exist.

[2] CIT *v.* Govinda Choudhury and Sons, 203 ITR 881 (SC)

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