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# Tax Flash News



25 September 2026

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# Non-convertible debentures and Rupee Denominated Bonds are distinct financial instruments; concessional tax rate not available for NCDs interest

## Executive summary

In the case of *Azure Power*,[1] the Delhi Bench of the Income-tax Appellate Tribunal ('the Tribunal') examined whether interest earned on investment in Non-Convertible Debentures ('NCDs') qualified for the concessional tax regime applicable to Rupee Denominated Bonds ('RDBs').

The Tribunal ruled against the taxpayer and held that NCDs and RDBs are distinct categories of debt instruments. The Revenue had argued that RDBs constitute a specific class of offshore instruments governed by a separate regulatory framework and that the legislature's use of the expression "rupee denominated bonds" reflected a conscious intent to distinguish such instruments from ordinary bonds and debentures (including NCDs). Accepting this reasoning, the Tribunal applied a strict interpretation of the statute and held that the concessional regime could not be extended to NCDs.

[1] *Azure Power Energy Limited* v. *ACIT* (IT(IT)A Nos. 37/Del/2026); *Azure Power Solar Energy Private Limited* v. *ACIT* (IT(IT)A Nos. 38/Del/2026) – former appeal was taken as the lead case.

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The Tribunal also examined the issue relating to the beneficial ownership of interest earned from External Commercial Borrowings ('ECB') for claiming the concessional tax rate under the India-Mauritius tax treaty ('the Treaty'). The Tribunal held that the taxpayer satisfied the beneficial ownership requirement, noting that the documentary evidence established its possession, use, risk and control over both the funds and the corresponding interest income. Accordingly, the taxpayer was held entitled to the concessional tax rate under the Treaty for ECB interest income.

## Facts of the case



The taxpayer, a Mauritius company registered with SEBI as Category III Foreign Portfolio Investor ('FPI'), earned interest income from India from the following sources:

### Interest income from ECB

The taxpayer raised funds by issuing solar green bonds listed on the Singapore Stock Exchange and deployed those funds to extend ECB to Indian group companies.

Interest earned on such ECB was offered to tax in India at the concessional tax rate of 7.5 per cent under the Treaty.[2]

However, the Revenue denied the Treaty benefit on the ground that the taxpayer was not the 'beneficial owner' of the interest income and taxed such income at 40 per cent (plus surcharge and cess).

### Interest income from investment in NCDs

The taxpayer also earned interest from investment in NCDs issued by the related Indian group companies.

In its India tax return, the taxpayer claimed the benefit of the concessional tax rate of 5 per cent (plus surcharge and cess) on such interest income under the Income-tax Act, 1961 ('the 1961 Act').[3]

The Revenue, however, rejected the claim on the ground that the concessional tax rate applies only to RDBs and not to NCDs and accordingly taxed the NCDs interest at the rate of 20 per cent (plus surcharge and cess).[4]

[2] Article11
[3] Section 115AD read with section 194LD
[4] Section 115AD read with section 196D

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## Relevant provisions

**Article 11(2)** of the Treaty provides for a concessional tax rate of 7.5 per cent on interest income paid to a Mauritius resident provided the beneficial owner of such interest is a tax resident of Mauritius.

**Section 115AD** of the 1961 Act provides that interest referred to in section 194LD shall be taxable at the concessional rate of 5 per cent.

**Section 194LD** of the 1961 Act provides for the tax deduction at source ('TDS') rate of 5 per cent for interest earned by Foreign Institutional Investors ('FIIs') and Qualified Foreign Investors ('QFIs') in respect of investment made by them in RDBs of an Indian company.

## Taxpayer's contentions

### ECB interest income

Relied on *Klaus Vogel's Commentary on Double Taxation Convention*, which explains the concept of 'beneficial ownership' in terms of control over both the asset and the income arising, i.e., the person who is free to decide whether or not the capital or other assets should be used or made available for use by others, or whether the yield therefrom should be used.

The various clauses in the 'Green Bond Scheme' demonstrated that the taxpayer bore the entire risk and exercised control over both the funds and the interest income.

Relied on *Fujitsu America*[5] decision to argue that in the absence of back-to-back arrangement, the taxpayer had 'dominion and control' over the income, and therefore the beneficial ownership test was satisfied in the instant case.

### NCDs interest income

RDBs and rupee denominated NCDs represent the same economic and legal relationship of borrowing and repayment. RDBs are rupee denominated debt instruments where the foreign exchange risk is borne by the investor and not by the issuer and do not constitute a separate category of instrument distinct from debentures/ NCDs.

The terms 'bond' and 'debenture' are not defined under the 1961 Act and should therefore be understood in their commercial and legal sense.

[5] *CIT* v. *Fujitsu America Inc.* [2023] 452 ITR 311 (Delhi)

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The taxpayer referred to the legal dictionaries, SEBI's Investor Guide for corporate bonds market, the Companies Act 2013,[6] the Securities Contracts (Regulation) Act, 1956,[7] and judicial precedents[8] rendered in the context of other provisions of the 1961 Act to argue that bonds and debentures are acknowledgement and obligations arising out of varying forms of debt and thus may be used interchangeably.

The concessional tax rate was introduced as an incentive with the objective to encourage foreign investment in India's debt markets. A narrow or restrictive interpretation of excluding NCDs from the ambit of RDBs merely because the legislature used the word 'bond' instead of 'debenture' would defeat the legislative intent.

The coordinate Bench of the Delhi Tribunal in *Heidelberg Cement AG*,[9] *Amplus Energy Solutions Pte. Ltd.*[10] and *Fusion Finance Limited*[11] have held that the term 'bond' appearing in section 194LD includes NCDs. Consequently, rupee denominated NCDs are eligible for the concessional tax rate.

If the present Bench disagreed with those decisions, then the matter be referred to a larger Bench of the Tribunal or alternatively the tax rate of 7.5 per cent under the Treaty should be granted.

## Revenue's contentions

### ECB interest income

The taxpayer lacked possession, use, risk and control over the funds and the corresponding interest income and therefore failed to satisfy the 'beneficial ownership' test to be eligible for the Treaty benefit.

The *Fujitsu America* decision was distinguishable as it dealt with the India–Cyprus tax treaty and not the India–Mauritius tax treaty.

### NCDs interest income

RDBs were specific financial instruments, beyond the debenture versus bonds debate. The word 'bond' appears at numerous places in the 1961 Act, but bond with qualifier "rupee denominated" is present only in certain provisions, setting the RDBs apart from the ordinary bonds. RDBs are meant for being floated offshore and are not interchangeable with debentures or NCDs floated in India.

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[6] Section 2(30) of Companies Act, 2013 and section 2(12) of the Companies Act, 1956

[7] Section 2(h) of the Securities Contracts (Regulation) Act, 1956

[8] *DIT* v. *Shree Visheshwar Nath Memorial Public Charitable Trust* [2011] 333 ITR 248 (Delhi)

[9] *Heidelberg Cement AG* v. *ACIT* [2022] 197 ITD 791 (Delhi Tribunal)

[10] *Amplus Energy Solutions Pte. Ltd.* v. *ACIT* [2025] 175 taxmann.com 1070 (Delhi Tribunal)

[11] *ITO* v. *Fusion Finance Limited (*IT(IT)A No. 14 and 15/Del/2025)

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The legislature's use of the specific qualifier "rupee denominated" indicated that the provision was intended to cover a distinct category of offshore instruments, as all bonds issued in India are inherently rupee-denominated and would not require such qualification. Bonds floated outside India could be in foreign currency or in India currency, requiring such qualification.

The purpose of the provision gets defeated if its interpretation was generalised to the extent of deriving meaning from dictionaries and other sources rather than from immediate sources such as the Finance Bill, RBI/MCA regulations and other developments relating to RDBs.

Based on the legislative history of section 194LC, relating to offshore RDBs ('Masala Bonds'), and section 194LD, the prevailing economic circumstances at the time of their introduction and the CBDT press releases,[12] the Revenue argued that it would be a selective and distorted interpretation to treat the bonds referred to in section 194LC as offshore instruments, while the RDBs referred to in section 194LD as including onshore NCDs.

The provisions of sections 194LC and 194LD are merged into one section[13] in the Income-tax Act, 2025 which mentions 'outside India'. This indicated that the expression "rupee denominated bonds" in section 194LD referred to offshore instruments.

Relied upon RBI Circulars/ Master Directions[14] and Circular issued by the Ministry of Corporate Affairs ('MCA')[15] to argue that RDBs issued to overseas investors are regulated by ECB framework and are not covered by the corporate rule related to debentures.[16] Further, ECB Framework is not applicable in respect of the investment in NCDs made by the registered FPIs in India.

Section 196D prescribes TDS rate applicable to any income earned by FIIs from the securities (including debentures)[17] with a specific exclusion for interest income covered by section 194LD. This specific exclusion showed a deliberate legislative effort to exclude RDBs from the meaning and scope of debentures.

[12] CBDT Press Release dated 17 September 2018 (Exemption to interest income on specified off-shore Rupee Denominated Bonds) and Press Release dated 21 May 2013 and 20 November 2013

[13] Section 393(2)

[14] RBI Master Direction No. 5/2015-16 dated 1 January 2016; RBI Circular No. 17 dated 16 January 2019, and other circulars/Master Directions issued from time-to-time

[15] General Circular No. 9/2016 dated 3 August 2016

[16] Rule 18(11) of the Companies (Share Capital & Debenture) Rules 2014

[17] The expression "securities" shall have the meaning assigned to it in section 2(h) of the Securities Contracts (Regulation) Act, 1956

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*Decisions relied upon by taxpayer distinguishable*

The decisions relied upon by the taxpayer are *per incuriam*.

Distinguished *Heidelberg Cement AG* and *Amplus Energy Solutions* on the ground that these decisions were rendered without considering the direct RBI/MCA framework specifically dealing with RDBs and relied on precedents rendered in different context. Accordingly, these decisions interpreted RDBs as a general term requiring interpretation with the aid of legal dictionaries and consequently equated bonds with debentures, instead of recognising RDBs as a distinct financial instrument.

In some of the case laws relied upon by the taxpayer, there is reference to an internal letter issued by the Pr. CCIT[18] ('the Pr. CCIT Letter') which opines that bonds include debentures for the purposes of section 194LD. Under the 1961 Act,[19] the statutory power to issue binding instructions to the lower authorities is given to the Central Board of Direct Taxes ('CBDT'). The Pr. CCIT Letter was an opinion of an officer and an internal communication within the income-tax department, without authorisation of the CBDT. Therefore, the Pr. CCIT Letter does not have authority of law and violated the statutory provisions.

## Tribunal's decision

### ECB interest eligible for the Treaty rate

The Tribunal decided in favour of the taxpayer and upheld its status as 'beneficial owner' for the purposes of the Treaty benefit.

The documentary evidence placed on record, including the Global Business Licence issued by the Financial Services Commission of Mauritius, the SEBI FPI registration, the Mauritius Tax Residency Certificate for the relevant FY, Form 1DF[20] and the Green Bond Scheme issued in Singapore, established the satisfaction of all the four parameters of possession, use, risk and control of the funds and the interest income.

No other material was found to substantiate that the taxpayer was merely a conduit entity without having any actual control and benefit in relation to the interest income and the funds forming part of the ECB.

[18] The Principal Chief Commissioner of Income Tax (International Tax), Delhi (letter dated 30 November 2017)

[19] Section 119

[20] Form 1DF is a declaration filed by eligible foreign investor for claiming the concessional TDS rate under section 194LD

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## NCDs interest not eligible for concessional tax rate

The Tribunal denied the benefit of the concessional tax regime in respect of the NCDs interest income. However, it directed the Revenue to examine afresh whether such interest income was eligible for relief under the Treaty.

Rejected the taxpayer's argument that debentures include bonds. Once the legislature has used the specific expression "rupee denominated bond", it implies the exclusion of all other categories of debt instruments.[21] There is no scope for importing into the statute words which are not there.[22]

Relied on the Supreme court decisions in *Dilip Kumar,*[23] and *American Express Bank*,[24] reiterating that taxation statutes require strict interpretation, and where the words are plain and unambiguous, the court is bound to give effect to their plain meaning.

Concurred with the Revenue's argument that the Pr. CCIT Letter relied upon in judicial precedents was not decisive as it did not carry any statutory force under the 1961 Act.[25]

Distinguished the coordinate Bench decisions relied upon by the taxpayer noting that those decisions, in turn, relied on the decisions rendered in a different context and dealt with the reverse question, i.e. whether debentures include bonds, rather than whether bonds include debentures, as in the instant case.

Declined to refer the matter to a larger bench, holding that none of the judicial precedents relied upon by the taxpayer had applied the stricter interpretation principle so as to form a binding precedent against the Revenue.

## Our comments



The ruling adopted a strict interpretation and held that NCDs and RDBs are distinct financial instruments, precluding extension of the concessional tax regime applicable to RDBs. Notably, the Tribunal distinguished contrary coordinate Bench rulings and declined to refer the issue to a larger Bench.

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[21] *GVVK Industries Ltd* v. *ITO* [2011] 332 ITR 30 (SC)
[22] *Smt. Tarulata Shyam* v. *CIT* [1977] 108 ITR 345 (SC)
[23] *Commissioner of Customs* v. *Dilip Kumar & Co* [2018] 9 SCC 1 (FB)(SC)
[24] *DIT* v. *American Express Bank Ltd.* [2025] 484 ITR 137 (SC)
[25] *K.P. Varghese* v. *ITO* [1981] 131 ITR 597 (SC)

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