

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 08.09.2015

CORAM

THE HONOURABLE MR.JUSTICE V.RAMASUBRAMANIAN
AND
THE HONOURABLE MR.JUSTICE T.MATHIVANAN

Tax Case (Appeal) Nos.1288 & 1290 of 2007

Infrastructure Development Finance Co.Ltd.,
ITC Centre, 3rd Floor
760, Anna Salai
Chennai 600 002

..Appellant in both the T.C.A.'s

-vs-

The Assistant Commissioner of Income Tax
Company Circle II(3)
Chennai 600 034

..Respondent in both the T.C.A.'s

Memorandum of Grounds of Tax Case Appeals under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal, Chennai "A" Bench, Chennai dated 29.3.2007 in I.T.A.No.2398/Mds/2003 against the order dated 05/09/2003 and 19/01/2005 and made in ITA.No.111/03-04/A-III and ITA TR.No.182/ITA 177/04-05 on the file of the Commissioner of Income Tax(Appeals)-III and XI, Chennai 34 respectively and against the order dated 21/03/03 for the assessment year 2000-2001 on the file of Deputy Commissioner of Income Tax, Company Circle II(3), Chennai-34 (in TC(A)1288/07) and against the order dated 30/03/04 and passed in G.I.No./P.A.No.IX 2-051/AAACI2663N on the file of Assistant Commissioner of Income Tax, Company Circle II(3), Chennai-34 for the assessment year 2000-2001 and in I.T.A.No.748/Mds/2005 for the assessment year 2001-2002.

For Appellant :: Mr.Farrokh V.Irani for
Mr.O.R.Santhanakrishnan

For Respondent :: Mr.T.R.Senthilkumar
Senior Standing Counsel

JUDGMENT

(Judgment of the Court was delivered by V.RAMASUBRAMANIAN, J.)

These two appeals are by the assessee.

2. Heard Mr.Farrokh V.Irani, learned counsel for the appellant/assessee and Mr.T.R.Senthilkumar, learned senior standing counsel for the Revenue.

3. Though five questions of law were framed in T.C.(A). No.1288 of 2007 and six questions of law were framed in T.C.(A). No.1290 of 2007 at the time when the appeals were admitted by this Court on 24.9.2007, it is stated by Mr.Farrokh Irani, learned counsel for the assessee that question Nos.4 & 5 in T.C.(A) No.1288 of 2007 and question No.6 in T.C.(A) No.1290 of 2007 are not pressed. As a consequence, questions 1 to 3 in T.C.(A) No.1288 of 2007 and questions 1 to 5 in the other appeal alone survive for consideration.

4. Questions 1 & 2 in both the appeals relate to the exemption claimed by the assessee under Section 10(23G) of the Income Tax Act in respect of liquidated damages payable by a borrower to the assessee in the event of a borrower committing default in repayment of the loan advanced by the assessee. Therefore, we will group questions 1 & 2 in T.C.(A) No.1288 of 2007 and questions 1 & 2 in T.C.(A) No.1290 of 2007 together for easy appreciation. These questions read as follows:-

"(1) Whether the Income Tax Appellate Tribunal erred in holding that the appellant was not entitled to the exemption under Section 10(23G) of the Income Tax Act in respect of liquidated damages?

(2) Whether the Income Tax Appellate Tribunal ought to have held that liquidated damages were entitled to the exemption under Section 10(23G) of the Act inter alia as such liquidated damages fell within the definition of "interest" in Section 2(28A) of the Act?"

5. The assessing officer, by his order dated 30.3.2004 in relation to the assessment years 2000-2001 and 2001-2002, held that the liquidated damages are a sort of compensation in nature received from defaulters and hence cannot be treated like income arising from the activities of the assessee in respect of infrastructure financing. At this stage it should be pointed out that T.C.(A) No.1288 of 2007 relates to the assessment year 2000-2001 and the next appeal relates to the assessment year 2001-2002.

6. The CIT(Appeals) affirmed the decision of the assessing officer in this regard. It was held by the CIT (Appeals) in respect of both the assessment years that liquidated damages cannot be equated to interest receipt or service fee etc. According to the CIT(Appeals), it was in the nature of a penalty levied once the default continued in the payment of principal, interest or penal interest. Consequently the CIT(Appeals) held that it is in the nature of compensation for the loss of profit which is revenue in nature.

7. On a further appeal to the Income Tax Appellate

Tribunal, the Tribunal held in paragraph-22 of its decision dated 29.3.2007 that the right to receive liquidated damages accrue on account of default in the payment of bills as stipulated in the agreement and did not arise on account of any delay in the payment of loan. Therefore the Tribunal affirmed the decision of the assessing officer and the CIT(Appeals) that the liquidated damages could not be construed as interest to attract the provisions of Section 10(23G) of the Act.

8. Before proceeding to consider the question of law, it should be pointed out that the finding recorded by the Tribunal in paragraph-22 of its order was also factually wrong. The liquidated damages, even as per the orders of the assessing officer and the CIT(Appeals), did not accrue on account of any default in the payment of bills as stipulated in the agreement. Admittedly, the appellant is an infrastructure development finance company, which provides long-term finance for infrastructure development projects. The liquidated damages charged by the assessee upon its borrowers, even as per the understanding of the assessing officer and the CIT(Appeals), was in the event of a default committed by the borrower in repayment of the principal and the interest. Therefore, it is clear that the Tribunal was caught wrong on the facts of the case, even at the outset.

9. Now coming to the question as to whether the liquidated damages would qualify for deduction under Section 10(23G), it is seen that Section 10 stipulated that any income falling within any of the clauses contained therein should not be included while computing the total income of a previous year of any person. Under clause (23G), any income by way of dividends (other than dividends referred to in section 115-O), interest or long term capital gains of an infrastructure capital fund or an infrastructure capital company or a co-operative bank from investments made on or after the first day of June, 1998 by way of shares etc., should not be included in the total income. Clause (23G) of Section 10 as it stood before it was omitted by the Finance Act, 2006 reads as follows:-

"(23G) any income by way of dividends, other than dividends referred to in section 115-O, interest or long-term capital gains of an infrastructure capital fund or an infrastructure capital company or a co-operative bank from investments made on or after the 1st day of June, 1998 by way of shares or long-term finance in any enterprise or undertaking wholly engaged in the business referred to in sub-section (4) of section 80-IA or sub-section (3) of section 80-IAB or a housing project referred to in sub-section (10) of section 80-IB or a hotel project or a hospital project and which has been approved by the Central Government on an application

made by it in accordance with the rules made in this behalf and which satisfies the prescribed conditions:

Provided that the income, by way of dividends, other than dividends referred to in section 115-O, interest or long-term capital gains of an infrastructure capital company, shall be taken into account in computing the book profit and income tax payable under section 115JB.

Explanation-1.--For the purposes of this clause,--

(a) "infrastructure capital company" means such company as has made investments by way of acquiring shares or providing long-term finance to an enterprise wholly engaged in the business referred to in this clause;

(b) "infrastructure capital fund" means such fund operating under a trust deed registered under the provisions of the Registration Act, 1908 (16 of 1908) established to raise monies by the trustees for investment by way of acquiring shares or providing long-term finance to an enterprise wholly engaged in the business referred to in this clause;

(c) [***]

(d) "long-term finance" shall have the meaning assigned to it in clause (viii) of sub-section (1) of section 36;

(e) "co-operative bank" shall have the meaning assigned to it in clause (dd) of section 2 of the Deposit Insurance and Credit Guarantee Corporation Act, 1961 (47 of 1961);

(f) "interest" includes any fee or commission received by a financial institution for giving any guarantee to, or enhancing credit in respect of, an enterprise which has been approved by the Central Government for the purposes of this clause;

(g) "hotel project" means a project for constructing a hotel of not less than three-star category as classified by the Central Government;

(h) "hospital project" means a project for constructing a hospital with at least one hundred beds for patients.

Explanation 2.--For the removal of doubts, it is hereby declared that any income by way of dividends, interest or long-term capital gains of an infrastructure capital fund or an infrastructure capital company from investments made before the 1st day of June, 1998 by way of shares or long-term finance in

any enterprise carrying on the business of developing, maintaining and operating any infrastructure facility shall not be included and the provisions of this clause as it stood immediately before its amendment by the Finance (No.2) Act, 1998 (21 of 1998) shall apply to such income;"

10. The liquidated damages earned by the assessee to the extent of Rs.2,98,617/- was admittedly on account of a default committed by a borrower. It will not fall under the category "income by way of dividends" under clause (23G) of Section 10. It may not even fall under the category of long-term capital gains etc. But the question is as to whether such income by way of liquidated damages would at least fall under the category of interest, as stipulated in Section 10(23G) or not. For finding an answer to this question, we may have to refer to the definition of the expression "interest" under Section 2(28A). The definition of the expression "interest" reads as follows:-

"(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;"

11. The definition of the expression "interest" has been construed by this Court in *Viswapriya Financial Services and Securities v. Commissioner of Income Tax*, 258 ITR 496 to be more exhaustive. The Court held in the said case as follows:-

"The definition of interest, after referring to the interest payable in any manner in respect of any moneys borrowed or debt incurred proceeds to include in the terms money borrowed or debt incurred, deposits, claims and "other similar right or obligation" and further includes any service fee or other charge in respect of the moneys borrowed or debt incurred which would include deposit, claim or other similar right or obligation, as also in respect of any credit facility which has not been utilised. This statutory definition regards amounts which may not otherwise be regarded as interest as interest for the purpose of the statute. Even amounts payable in transactions where money has not been borrowed and debt has not been incurred are brought within the scope of the definition as in the case of a service fee paid in respect of a credit facility which has not been utilised. Even in cases where

there is no relationship of debtor and creditor or borrower and lender, if payment is made in any manner in respect of any moneys received as deposits or on money claims or rights or obligations incurred in relation to money, such payment is, by this statutory definition, regarded as interest."

12. It must be remembered that under the terms of a loan agreement, a borrower is imposed with a primary obligation to repay the principal together with interest. An additional obligation is cast upon a borrower to pay interest on interest or penal interest, in the event of borrower committing a default upto a particular level. In some finance agreements, the finance companies also stipulate the payment of liquidated damages, if the default exceeds a particular tolerance limit. Irrespective of what the finance company itself may choose to term it, such liquidated damages cannot be excluded from the definition of the expression "interest" under Section 2(28A), as the definition is so exhaustive. The definition is so exhaustive as to include even any service fee or other charge that is levied in respect of the monies that remain unutilised.

13. In certain cases, the lenders impose an obligation on the borrowers to pay the commitment charges, if after the sanction of the loan, the borrower could not make use of the funds upto a particular point of time. The definition of the word "interest" under Section 2(28A) includes even such commitment charges. Therefore we are of the considered view that all the three authorities committed a mistake in understanding the scope of the expression "liquidated damages" and in coming to a conclusion that the same would not come within the purview of the word "interest" under Section 2(28A). Hence the questions of law 1 & 2 in T.C. (A) Nos.1288 & 1290 of 2007 are answered in favour of the assessee.

14. Question No.3 in T.C. (A) No.1290 of 2007: The third question in T.C. (A) No.1290 of 2007 relates to what is known as Debt Syndication Fee. Insofar as this issue is concerned, the assessing officer held that the debt syndication fee is a fee charged by the assessee from the borrower, when the assessee funded the project not only from out of their own monies, but also by arranging finance from others. Therefore, in his order, the assessing officer held that though what is charged as debt syndication fee may be a service fee, the same would not come within the purview of Section 10(23G), on account of the fact that the said fee is not charged for the money that was lent by the assessee themselves.

15. This finding of the assessing officer was also approved by the CIT(Appeals) in his orders in respect of the assessment year 2001-2002.

16. Before the CIT(Appeals), the assessee sought to rely upon Explanation 1(f) under Section 10(23G). But the CIT (Appeals) held that even if the Explanation 1(f) would be applicable, it will be applicable only from the assessment year 2002-03 and not in relation to the assessment year 2001-02 or any previous year.

17. The Tribunal agreed with the views of the assessing officer and CIT(Appeals) to the effect that the debt syndication fee represented a charge collected by the assessee for the preparation of information of memorandum, financing of business plan and negotiation charges with the bank and financial institutions. Therefore the Tribunal held in paragraph-24 of its order dated 29.3.2007 that the debt syndication fee cannot constitute interest within the purview of Section 2(28A).

18. In other words, all the three authorities agreed on one point, namely, that if the assessee had collected the debt syndication fee for the monies advanced by them, then the same would fall within the definition of the expression "interest". According to all the three authorities, if the debt syndication fee is charged in respect of a loan arranged by the assessee from other financial institutions, the same would not come within the purview of the definition under Section 2(28A).

19. But at the outset, we do not find that such a distinction is borne out of Section 2(28A). While dealing with the interpretation to be given to the expression "interest" under Section 2(28A), we have indicated as to how the definition is very exhaustive. The definition is not merely an inclusive definition. The expression "interest" is not only defined to include something, but also defined to mean something and also to include something else. If the second part of the definition in Section 2(28A) is carefully looked into, it could be seen that what is included therein is "any service fee". By itself, Section 2(28A) does not make a distinction between a service fee charged in respect of the loans advanced by the assessee and those in respect of the loans organised from other financial institutions. In the absence of any indication either in Section 2(28A) or in 10(23G), we do not think that the distinction made out by the respondent could be approved. Hence the third question of law in T.C.(A) No.1290 of 2007 is also answered in favour of the assessee.

20. Debenture Trusteeship Fees: The fourth question in T.C.(A) No.1290 of 2007 relates to the question whether debenture trusteeship fees charged by the assessee/appellant would come within the meaning of the expression "interest" under Section 2(28A) or not.

21. The assessing officer construed debenture trusteeship fee as an income derived by the assessee, not from the primary business of lending carried on by them, but from an ancillary

service rendered by them. The CIT(Appeals) approved of the same with a caveat that may be from the assessment year 2002-03, the assessee may be entitled to the benefit of Explanation 1(f) of Section 10(23G). In other words, the CIT(Appeals) was of the view that after the introduction of Explanation 1(f), debenture trusteeship fees would come within the purview of Section 10(23G) and not before.

22. The Tribunal simply affirmed the findings of the assessing officer and the CIT(Appeals), without getting into greater detail.

23. Before looking into the provisions, we must first understand the nature of this debenture trusteeship fee. The debenture trusteeship fee is something that a financial institution is entitled to charge, when such a company is registered with the SEBI as a Debenture Trustee under Chapter X of the Guidelines for the issue of Debt Instrument under SEBI (Disclosure & Investor Protection) Guidelines, 2000. Under these Guidelines, a borrower is required to appoint a Debenture Trustee for issue of Debt Instruments. A fee is paid by the borrower for the debt borrowed. The assessing officer as well as the CIT(Appeals) did not go into the prescription contained in the aforesaid Guidelines of SEBI.

24. Interestingly, in respect of the assessment year 2000-01, the CIT(Appeals) held that the debenture trusteeship fee is eligible for exemption under Section 10(23G). The order of the CIT(Appeals) in relation to the assessment year 2000-01 has attained finality and the department has not taken it on appeal to the Tribunal. In paragraph-3.3 of his order dated 5.9.2003, the CIT(Appeals) specifically dealt with this aspect in relation to the assessment year 2000-01. Therefore to hold that for the assessment year 2000-01 debenture trusteeship fee would come within the purview of Section 10(23G) but it would not come within the purview of the section in relation to the next assessment year, may not be proper. Hence the fourth question of law in T.C.(A) No.1290 of 2007 is also to be answered in favour of the assessee.

25. That leaves us only with the third question in T.C.(A) No.1288 of 2007 and the fifth question in T.C.(A) No.1290 of 2007. Since they are identical, they are extracted only once as follows:-

"Whether the Income Tax Appellate Tribunal erred in holding that the deduction to which the appellant was entitled under Section 36(1)(viia)(c) of the Act was to be granted after reducing from the appellant's income, the deduction to which the appellant was entitled under Section 36(1)(viii) of the Act?"

26. In short, the question that falls for consideration is as to whether the deduction should first be allowed in terms of Section 36(1)(viii) for the application of the deduction under Section 36(1)(viia)(c).

27. All the three authorities were of the unanimous view that there is a distinction between the two types of deduction. The deduction allowable under Section 36(1)(viii), after its amendment under the Finance Act, 1995, is on the profits derived from business. The deduction allowable under Section 36(1)(viia)(c) is on the total income. Therefore the authorities held that the deduction under clause (viii) will have to be computed first before applying the deduction under clause (viia)(c).

28. But keeping aside the amendment introduced in 1995 for a moment, if we have a look at the import of Section 36(1) by itself, it is clear that sub-section (1) of Section 36 lists out the matters in respect of which deductions can be allowed while computing the income referred to in Section 28. Clauses (i) to (xi) of sub-section (1) of Section 36 did not make any of those matters dependent upon one another. If an assessee is entitled to the benefit under one clause of sub-section (1) of Section 36, the assessee was not deprived of the benefit of the other clause. This is how several clauses in sub-section (1) have been arranged.

29. It is true that before the amendment introduced under the Finance Act, 1995, the deduction to be allowed under clause (viia)(c) and clause (viii) were placed on par. The deduction was only on the total income. But, as rightly contended by the learned counsel for the appellant, the amendment did not change the character of the deduction, but changed merely the method of computation. Instead of directing the assessee to compute it at 40 percent on the total income, the amendment directed the assessee to compute the deduction at 40 percent on the profits derived out of business.

30. Such an interpretation is what appears to be borne out by the memorandum explaining the provisions in the Finance Bill, 1995, whereunder the amendment was introduced. The relevant portion of the memorandum reads as under:-

"Under clause (viii) of sub-section (1) of section 36 of the Income Tax Act, 1961, an approved financial corporation engaged in providing long-term finance for industrial or agricultural development in India, or an approved public company formed and registered in India with the main object of carrying on business of providing long-term finance for construction or purchase of residential houses, is entitled for a deduction of an amount not exceeding 40 per cent of its total income carried to a

special reserve. The deduction is allowed on the "total income" and not with reference to the income from the activities specified in section 36(1)(viii).

These organisations have diversified their activities and are claiming deduction under this section even in respect of their income from activities other than those specified in this section. There is no justification for allowing the deduction with reference to income from other activities or from sources other than business. It is, therefore, proposed to limit the deduction of 40 per cent only to the income derived from providing long-term finance for the activities specified in section 36(1)(viii). It will thus take outside the purview of deduction, income arising from other business activities or from sources other than business."

31. If each of the clauses under sub-section (1) of Section 36 is independent in its operation and if each one of them does not depend upon the other clause for the extension of the benefit, then the interpretation given by the respondent cannot be accepted.

32. Yet another distinction brought forth by the learned counsel for the appellant, also deserves consideration. While the benefit of deduction under clause (viia)(c) is available to any public financial institution or State financial corporation or State industrial investment corporation, in respect of a provision for bad and doubtful debts, the benefit of the deduction under clause (viii) is available only for the financial corporations engaged in providing long-term finance for industrial or agricultural development or development of infrastructure facility in India. Therefore, if the interpretation as given by the authorities are accepted, the benefit that will accrue to a finance corporation incorporated in India and providing long-term finance for infrastructure development would be lesser than what is received by the foreign banks and foreign financial institutions. This could not have been the purport of the amendment brought forth under the Finance Bill, 1995.

33. Therefore the third question in T.C.(A) No.1288 of 2007 and the fifth question in T.C.(A) No.1290 of 2007 are also answered in favour of the assessee. In fine, both the tax case appeals are allowed. No costs.

Sd/
ASSISTANT REGISTRAR (CS-IV)

/TRUE COPY/

SUB-ASSISTANT REGISTRAR

SS

To

1. The Income Tax Appellate Tribunal
Chennai "A" Bench
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T.C.(A)Nos.1288 & 1290 of 2007

CO-VD

JD 04/01/2016

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