IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 10.09.2018

CORAM

THE HONOURABLE MR.JUSTICE T.S.SIVAGNANAM
and
THE HONOURABLE MRS.JUSTICE V.BHAVANI SUBBAROYAN

Tax Case (Appeal) Nos.1148 and 1149 of 2008

M/s.Palghat Permanent Fund Ltd.,
16, Nana Street, T.Nagar,
Chennai-600 017.
... Appellant/Respondent in both Appeals

-vs-

The Asst. Commissioner of Income Tax,
Circle V(1), Chennai-600 034.
... Respondent/Appellant in both Appeals

Prayer: Tax Cases (Appeals) filed under Section 21 of the Interest Tax Act, 1974 read with Section 260A of the Income Tax Act, 1961 against the common order of the Income-tax Appellate Tribunal Chennai 'B' Bench, Chennai dated 27.07.2007 in Int.Tax.A.Nos.78 and 79/Mds/2003 for the assessment years 1999-2000 and 2000-01 respectively. Against the Order of the Commissioner of Income Tax (Appeals), V Made in ITA.No. 34 & 35 of 2002-2003 dated 22.01.2003 preferred against the Order of the Assistant Commissioner of Income Tax, Company circle V (1), Chennai-34, dated 13.03.2002 made in 51134P of the Assement year 1999-2000 and 2000-2001.

For Appellant : (in both Appeals)	Mr.A.S.Sriraman for Mr.S.Sridhar
For Respondent : (in both Appeals)	Mr.M.Swaminathan, Senior Standing Counsel and Mrs.V.Pushpa, Junior Standing Counsel

COMMON JUDGMENT
[Delivered by T.S.Sivagnanam, J.]

These appeals, filed by the assessee under Section 260A of the Income-tax Act, 1961 (hereinafter referred to as "the Act"), are directed against the common order dated 27.07.2007, passed by the Income-tax Appellate Tribunal Chennai 'B' Bench (in short, "the Tribunal"), Chennai dated 27.07.2007 in Int.Tax.A.Nos.78 and 79/Mds/2003 for the assessment years 1999-2000 and 2000-01 respectively.

2.The above appeals have been admitted, by order dated 13.08.2008, on the following substantial questions of law:-

> "(i) whether on the facts and in the circumstances of the case, the Appellate Tribunal was justified and correct in law in upholding the levy of interest tax on the penal/default interest collected even though the charging provisions of the Act envisaged such levy on the loans and advances only?
>
> (ii) Whether the Appellate Tribunal was justified in holding that the provisions of Section 2(7) of the Act would be attracted to the facts of the case in view of the wrong assumption of facts on the amounts received as recorded in para 5 of the impugned order and in the process whether the Appellate Tribunal was justified in confirming the action of the respondent in expanding the scope of the 'chargeable interest' as defined?
>
> (iii) Whether on the facts and in the circumstances of the case the Appellate Tribunal was justified in upholding the levy of interest tax on the penal/default interest collected even though the First Appellate Order was based on another First Appellate Order rendered under similar circumstances accepted by the Revenue especially the appeals preferred by the Revenue in the Appellant's case were not maintainable in view of the decisions rendered by the Apex Court?"

3.The assessee is a non-banking financial institution engaged in the business of operating chit funds and they have filed revised returns for the relevant assessment years returning the chargeable interest.

4.During the course of assessment, the Assessing Officer found that the assessee had included default interest (penal interest) in chargeable interest and hence, they were asked to show cause as to why the default interest (penal interest) should not be included in chargeable interest.

5.The assessee contended that default interest is in the nature of penal interest received by the assessee in cases where borrowers default on repayments within the due dates agreed to and hence, it has the character of interest on interest. It was further contended that default interest (penal interest) has the nature of compensation received from borrowers, who default on repayments within the due dates and therefore, it is out of the purview of chargeable interest as defined in the Interest Tax Act, 1974.

6.The Assessing Officer did not accept the stand taken by the assessee and held that any compensation received by the lender from the borrower, whatever name it is given, has the character of interest on loans or advances and accordingly, completed the assessment holding that the default interest (penal interest), received by the assessee, has the nature of interest on loans and advances and thus, chargeable to interest tax within the meaning of Sections 2(1) and 5 of the Interest Tax Act. Aggrieved by such order, the assessee preferred appeal before the Commissioner of Income-tax (Appeals)-V (CIT(A)). By order dated 22.01.2003, the CIT(A) followed the decision in the case of Shenoy Nagar Saswatha Nidhi Limited in ITA Nos.39 and 40/1999-2000-CIT(Appeals)-IV dated 11.02.2000 and deleted the addition made by the Assessing Officer for both the assessment years.

7.In the said decision, in the case of Shenoy Nagar Saswatha Nidhi Limited (supra), it was held that Interest Tax Act authorities levy tax on interest on loans and advances and such other items specified in Section 2(7) of the Interest Tax Act and from its scope, penal interest and interest of compensatory nature which partakes the character of interest on interest, are excluded. Aggrieved by the said order, the Revenue preferred appeal before the Tribunal. The Tribunal, by order dated 27.07.2007, allowed the appeal filed by the Revenue. Aggrieved by the same, the assessee is before us by way of these appeals.

8.Heard Mr.A.S.Sriraman, learned counsel for the appellant and Mr.M.Swaminathan, learned Senior Standing Counsel for the respondent.

9.The issue, which falls for consideration, is whether the penal interest collected by the assessee would fall within the ambit of the Interest Tax Act and more particularly, within the definition of Section 2(7) of the Interest Tax Act. The said provision reads as follows:-

"Section 2(7), Interest Tax Act, 1974

2. In this Act, unless the context otherwise requires,

(7) "interest" means interest on loans and advances made in India and includes

(a) commitment charges on unutilised portion of any credit sanctioned for being availed of in India; and

(b) discount on promissory notes and bills of exchange drawn or made in India, but does not include-

(i) interest referred to in sub-section (1B) of Section 42 of the Reserve Bank of India Act, 1934 (2 of 1934);

(ii) discount on treasury bills;"

10.In terms of the "definition" of interest as defined in Section 2(7) of the Interest Tax Act, it means interest on loans and advances made in India. It includes two other categories and excludes two other categories. But, in these appeals, we are not constrained about such inclusion or exclusion, as it is the case of the Revenue that the charges collected by the assessee would fall within the inclusive definition of interest under Section 2(7) of the Interest Tax Act.

11.The case of the Revenue is pitched on the sole point that whatever that has been collected is on loans and advances extended by the assessee and in whatever name it might have been collected, it would fall within the definition of interest under Section 2(7) of the Interest Tax Act.

12.More or less identical question came up for consideration before a Division Bench of this Court in the case of Commissioner of Income Tax vs. Cholamandalam Investment & Finance Co. Ltd. reported in (2008) 296 ITR 0601 wherein, the substantial question of law, which was framed for consideration, was whether the Tribunal was right in excluding additional discount charges from the chargeable interest under the Interest Tax Act. The Division Bench, after referring to the decision in the case of Commissioner of Income-tax vs. State Bank of Travancore reported in (1997) 228 ITR 40 (Ker), held that interest on loans and advances and the additional discount charges would not attract the provisions of the Interest Tax Act. The operative portions of the judgment read as follows:-

"3. To decide the issue whether the additional discount charges are not liable to tax under Interest-tax Act, it is useful to refer the decision in CIT vs. State Bank of Travancore (1997) 140 CTR (Ker) 358 : (1997) 228 ITR 40 (Ker) wherein the Kerala High Court held that the character of an overdue bill is wholly distinct from loans and advances and the interest on the loans and advances alone is taxable under the Interest-tax Act and the character of an overdue bill is not synonymous with loans and advances and therefore, the interest on overdue bills is to be excluded from chargeable interest under the Interest-tax act.

4. Applying the above ratio to the facts of the case, we hold that the Interest-tax Act is attracted only in respect of interest on loans and advances and the additional discount charges which is an amount given as a premium, would not attract the provisions of the Interest-tax act. The Tribunal is therefore correct in excluding additional discount charges from the chargeable interest under the Interest-tax Act."

13.In the case of Commissioner of Income-tax vs. Bank of Rajasthan Ltd. [2010] 323 ITR 524 (Rajasthan), it was held that interest or penal interest charged by the assessee on the delayed payment of instalments by the depositors of the recurring deposit accounts, is not exigible to tax under the provisions of the Interest-tax Act, 1974.

14.Similar view was taken in the case of Commissioner of Income-tax vs. State Bank of Indore reported in [1988] 172 ITR 24 (MP) wherein the Court held that the Tribunal was not right in holding that the amounts charged by the assessee for delayed payment of bills of entry were in the nature of interest on advances and exigible to tax under the Act.

15.The High Court of Karnataka, in the case of State Bank of Mysore vs. Commissioner of Income-tax reported in (1989) 175 ITR 607 (Kar.), held that interest is the damages or compensation for delayed payment of money due and therefore, the expression 'compensation' in Section 32 of the Negotiable Instruments Act, will include interest paid by way of damages or compensation for delayed payments. It was further, held that any amount collected by the Bank cannot be anything but interest, whatever may be the nomenclature, and is chargeable interest for the purpose of Interest Tax Act.

16.All the aforementioned decisions were considered for its correctness by the Hon'ble Supreme Court in the Case of State Bank of Patiala vs. Commissioner of Income-tax, Patiala reported in [2016] 383 ITR 244 (SC). The Hon'ble Supreme Court held that the view of the High Court of Karnataka in the case of State Bank of Mysore (supra) is directly in conflict with the decision of the Hon'ble Supreme Court in the case of Commissioner of Income-tax vs. Sahara India Savings & Investment Corpn. Ltd. [2009] 17 SCC 43 and therefore, held that a contrary view cannot be countenanced.

17.It was further pointed out that "loans and advances" has been held to be different from discounts and legislature has kept in mind the difference between the two and it is clear that the right to charge for overdue interest by the assessee banks did not arise on account of any delay in repayment of any loan or advance made by the said banks and this right arose on account of default in payment of amounts due under a discounted bill of exchange. Further, it was held that a subject can be brought to tax only by a clear statutory provision in that behalf and interest is chargeable to tax under Interest Tax Act only if it arises directly from a loan or advance. This finding was explained by stating that it is clear from the use of the word "on" in Section 2(7) of the Interest Tax Act that interest payable "on" a discounted bill of exchange cannot be equated with interest payable "on" a loan or advance. With the above finding, the Court held that the reasoning contained in the judgments of the High Court, which differ from the High Court of Karnataka is correct. The Court then proceeded to deal with the expression "interest" as defined under the Income Tax Act in Section 2(28A) and held as follows:-

> "18.It will be noticed that this definition is much wider than that contained in Section 2(7) of the Interest Tax Act, 1974. The expression "payable in any manner in respect of any moneys borrowed" is an expression of considerable width. It will be noticed that the aforesaid language of the definition section contained in the Income Tax act is broader than that contained in the Interest Tax Act in three respects. Firstly, interest can be payable in any manner whatsoever. Secondly, the expression "in respect of" includes interest arising even indirectly out of a money transaction, unlike the word "on" contained in Section 2(7) which, we have already seen, connotes a direct arising of payment of interest out of a loan or advance. And thirdly, "any moneys borrowed" must be contrasted with "loan or advances". The former expression would certainly bring within its ken moneys borrowed by means other than by way of loans or advances. We therefore conclude that the Interest Tax act, unlike the Income Tax Act, has focused only on a very narrow taxable event which does not include within its ken interest payable on default in payment of amounts due under a discounted bill of exchange."

18.In the light of the above referred decisions, the order passed by the Tribunal does not lay down correct legal position and accordingly, the same calls for interference.

19.In the result, the appeals filed by the assessee are allowed, the order passed by the Tribunal, is set aside and the substantial questions of law framed for consideration are answered in favour of the assessee. Consequently, the order passed by the CIT(A) dated 22.01.2003, is restored. No costs.

Sd/-
Assistant Registrar(CS-VI)

//True Copy//

Sub Assistant Registrar

abr

To

1.The Asst. Commissioner of Income Tax,
Company Circle V(1), Chennai-600 034.

2.The Income-tax Appellate Tribunal Chennai 'B' Bench, Chennai.

3.The Commissioner of Income-tax (Appeals)-V,
121, Mahatma Gandhi Road, Chennai-600 034.

4. The Assistant Registrar,
Income Tax Appellate Tribunal,
Rajaji Bhavan, Besant Nagar,
Chennai.

+1cc to Mr.S.Sridhar, Advocate, S.R.No. 62889
+1cc to Mr.M.Swaminathan, Advocate, S.R.No. 63314

T.C.(A) Nos.1148 & 1149 of 2008

SSV(CO)
GN(26/10/2018)