

IN THE HIGH COURT OF JUDICATURE AT MADRAS

RESERVED ON: **21.02.2019**

DATED: **01.03.2019**

CORAM

THE HON'BLE DR.JUSTICE VINEET KOTHARI
AND
THE HON'BLE MR.JUSTICE C.V.KARTHIKEYAN

Tax Case Appeal No. 939 of 2008

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

Appellant/Appellant/Appellant

Vs.

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

Respondent/Respondent/Respondent

Tax Case Appeal filed under Section 260A of the Income Tax Act, 1961
against the order of the Income Tax Appellate Tribunal, Madras 'A' Bench,
Chennai, dated 30.11.2007 made in ITA No.795/Mds/2006.

For Appellant : M/s. Farook I. Irani
for M/s. O.R.Santhanakrishnan

For Respondent : Mr.Karthik Ranganathan
Standing Counsel
Assisted by S.Rajesh &
D.Prabhu Mukunth, Arun Kumar
Senior Standing Counsel

J U D G M E N T

(Delivered by **C.V.KARTHIKEYAN, J.**)

The Assessee has filed the present Appeal calling into question the order of

the Income Tax Appellate Tribunal dated 30.11.2007. The Substantial questions on which the Appeal had been admitted on 08.07.2008 are as follows:-

“(i) 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 the liquidated damages?; and

“(ii) 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 not 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.”

2. The appellant is a Public Limited Company incorporated on 30.01.1997 with the main object of providing Long Term Finance to enterprises engaged in developing, maintaining and operating infrastructure projects and facilities.

3. In the Assessment Year 2002-2003, matters surrounding which this appeal is concerned about, the appellant claimed exemption under Section 10(23G) of the Income Tax Act, 1961 (“the Act”) in respect of interest income earned by it from long term finance provided to enterprises undertaking developing, maintaining and operating infrastructure facilities. The Appellant claimed entitled for exemption with respect to the Liquidated Damages which had been received from the borrowers on account of default on their part in

making payments as per the terms of the loan agreements entered into by them with the appellant.

4. The appellant in the Assessment Year 2002-2003 also claimed deductions under Section 36(1)(viia)(c) and independently under Section 36(1)(viii) of the Act in respect of provisions made for bad and doubtful debts.

5. The Assessing Officer, by order dated 28.03.2005, held that the appellant was not entitled for exemption under Section 10(23G) of the Act since, he opined that the amounts earned by the Appellant did not constitute 'interest' as defined under Section 2(28A) of the Act. The Assessing Officer also held that the claim for deduction under Section 36(1)(viia)(c) can be allowed only after reducing from the appellant's income, the deduction allowable under Section 36(1)(viii) of the Act and that deductions cannot be granted independent of each provision.

6. The Commissioner of Income Tax (Appeals) by order dated 22.02.2006 affirmed the decision of the Assessing Officer, and rejected the contentions of the appellant. Before the Commissioner of Income Tax, the Appellant had put forth an argument that the receipts by way of Liquidated Damages came within the definition of 'interest' as defined under Section 2 (28A) of the Act and had also insisted that it was entitled to a deduction under Section 36(1)(viia)(c) of the Act to the extent of 5% of the total income before reducing

therefrom, the deduction to which the appellant was entitled under Section 36(i)(viii) of the Act.

7. Aggrieved by the order of the Commissioner of Income Tax (Appeals), the Appellant had preferred a further Appeal before the Income Tax Appellate Tribunal. The Tribunal by its order dated 30.11.2007, which order is under challenge before us, followed its earlier consolidated order dated 29.03.2007 in the appellant's own case for the Assessment Years 1999-2000 to 2000-2001 and upheld the order of the Commissioner of Income Tax (Appeals) both with respect to denial of the claim for exemption under Section 10(23G) of the Act in respect of Liquidated Damages earned and with respect to the claim to entitlement for deduction under Section 36(i)(viii)(c) of the Act before reducing therefrom the deduction under Section 36(i)(viii) of the Act.

8. Heard Mr. Farook Irani, learned counsel for the appellant/Assessee and Mr. Karthik Ranganathan, learned Standing Counsel for the respondent/Revenue.

Question 1: Claim for exemption under Section 10(23G) of the Act:-

9. Section 10 of the Act, deals with "incomes not included in total income". It falls under Chapter III of the Act. The provision stipulates that any income falling within any of the Clauses under Section 10 should not be included while computing the total income of the previous year of any Assessee.' 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, read as follows:-,

“(23G) any income by way of dividends, other than 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 cooperative bank from investments made on or after 1st June, 1998 by any 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 80-1AB 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, that 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 investment by way of acquiring shares or providing long-term finance to an enterprises 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 Appellant to an extent of Rs.21,28,296/- were admittedly on account of defaults committed by the borrowers. It is claimed that this income would not fall under the category income by way of dividends as provided under Clause 23(G) of Section 10 of the Act. As a matter of fact, it can be held that it may not even fall under the category of long term capital gain etc. But the question whether such income

earned by way of Liquidated Damages would fall under the category of interest, as stipulated under Section 10 (23G) or not, can be determined only on examining the definition of the expression 'interest' as provided under Section 2 (28A) of the Act.

“2(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. Mr.Farook I. Irani, the learned counsel for the Appellant placed strong reliance on the Judgement in relation to the Appellant itself of a Co-ordinate Bench of this Court in ***TCA Nos. 1288 to 1290 of 2007*** dated 08.09.2015 pertaining to the Assessment Years 2000-2001 and 2001-2002. Mr.Irani insisted that the Division Bench had upheld the claim of the appellant and had interpreted the expression “interest” under Section 2(28A) as being very exhaustive so as to include any service or other charge if that is levied in respect of the monies that remain unutilised. In the said Judgement, the Co-ordinate Bench of this Court had relied on the Judgement reported in ***258 ITR 496 (Madras)*** in the case of ***Viswapriya Financial Services and Securities Vs. Commissioner of Income Tax***. It had been held in Paragraph No. 11 as follows:-

*"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 debts 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."

12. It is seen that an inference can be drawn that there are instances when lenders of money on long term basis impose an obligation on the borrowers to pay commitment charges. This is necessitated since after the sanction of the loan, the borrower could not make use of the funds upto a particular point of time. In the Judgement of the Co-ordinate Bench, this aspect has been dealt with as follows:-

"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.”

13. On the other hand, Mr.Karthik Ranganathan, learned Standing Counsel for the respondent urged that the word “charge” as stated in Section 2(28A) would only mean to include charges collected by banks or financial institutions for services rendered which are a pre-requisite for the sanction of any loan. He included under this category provisional charges, processing charges and though it was not specifically mentioned, it could also be extended to include charges paid to determine the credit worthiness of the borrower. In effect, the learned Standing Counsel stated that the word “charge” cannot mean and include the term “Liquidated Damages”.

14. To determine this aspect, reference may be drawn, with advantage, to the agreement which the appellant had entered into with its borrowers. The proforma of an agreement between BPL Mobile Communications Limited and the appellant, dated 02.02.2000 had been provided by Mr.Irani. In the said agreement, in Clause 2.9, it had been provided as follows:-

“2.9 Liquidated Damages on Defaulted Amounts:-

In case of default in redemption of the Debentures, payment of interest, and all other monies (except liquidated damages) on their respective due dates, the Borrower shall pay on the defaulted amounts, liquidated damages at the rate of 2.10% per annum for the period of default. Liquidated damages shall be payable in the manner and on the dates referred to in Section 2.4(1) hereof for payment of interest. Arrears of liquidated damages shall carry interest at the rate mentioned in Section 2.4(iv) prevailing as on the date of such default.”

15. A plain reading of the above shows that in the case of default in redemption of default payment of interest and all other monies (except Liquidated Damages) on their respective due dates, Liquidated Damages at the rate of 2.10% per annum is levied and is payable by the borrowers for the period of default.

16. It is also seen that arrears of Liquidated Damages shall carry interest at the rate mentioned in Clause 2.4(iv) which provided as follows:-

“All interest on the Debentures and on all other monies accruing and due under this Agreement shall, in case the same be not paid on the respective due dates, carry further interest at the rate of 2.5% (plus applicable interest tax), over and above the interest rate mentioned in (i) and (iii) above prevailing on the date of such default. Such interest will be computed from the respective due dates and shall become payable upon the footing of

compound interest with quarterly rests as provided above and shall be payable in the manner and on the dates specified in (1) above. ”

17. It is thus seen that though the term Liquidated Damages is used in the agreement, it actually signifies interest claimed by the appellant. This term “interest” would come within the word 'charge' as provided under the definition of interest in the Act. This had also been held by the Co-ordinate Bench in T.C.A.Nos. 1288 to 1290 of 2007 dated 08.09.2015 in the Appellant's own case. It was held as follows:-

“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 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."

We are in agreement with that finding.

Consequently, we hold that the three authorities had erred in understanding the scope of the expression 'Liquidated Damages' while coming to a conclusion that it would not come within the purview of the word "interest" under Section 2(28A) of the Act.

18. We therefore answer Question No. 1 in favour of the appellant.

Question No. 2: Claim for deduction under Section 36(1)(vii)(c) after

reducing from the appellant's income deduction under Section 36(i)(viii) of the Act:-

19. The issue which arises is whether deduction should be firstly allowed in terms of Section 36(1)(viii) for the application of the deduction under Section 36(1)(viia)(c).

20. Section 36(i)(viia)(c) is as follows:-

Section 36 deals with other deductions.

Section 36(viia) (c) deals with in respect of any provisions for bad and doubtful debts made by --

(c) a public financial institution or a State financial corporation or a State industrial investment corporation, an amount not exceeding five percent of the total income (computed before making any deduction under this clause and Chapter VI-a."

21. Section 36 is included in Chapter - IV of the Act relating to Computing of Business Income. Chapter VI-A relates to "Deductions in respect of certain Payments".

Section 36 (1)(viii) is as follows:-

"in respect of any special reserve created and maintained by a financial corporation which is engaged in providing long-term finance for industrial or agricultural development or development of infrastructure facility in India or by a public company

formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes, an amount not exceeding forty per cent of the profits derived from such business of providing long-term finance (computed under the head "profits and gains of business or profession" before making any deduction under this clause) carried to such reserve account."

22. In the explanation, eligible business had been stated to be business in respect of the specified entity referred to in sub-clause (i) or sub-clause (ii) or sub-clause (iii) or sub-clause (iv) of clause (a), namely the business of providing long-term finance for -

- (a) industrial or agricultural development;
- (b) development of infrastructure facility in India; or
- (C) development of housing in India.

23. It is an admitted fact that the appellant comes within the definition of a 'specified entity' and is carrying on 'eligible business' as provided under Section 36(1)(viii) of the Act.

24. It is the contention of Mr.Karthik Ranganathan, learned Standing

Counsel for the respondent that the deduction should be made only on the total income. However, before the amendment, introduced under the Finance Act 1995, the deduction to be allowed under Clause (vii)(a)(c) and Clause (viii) were placed on par. The amendment did not change the character of the deduction but changed the method of computation. By the amendment, an Assessee was permitted to compute deduction at 40% of the profits derived out of business and not 40% of the total income. This was a significant shift in the method of computation. This interpretation is borne out by the Memorandum explaining the provisions in the Finance Bill 1995 whereunder the amendment was introduced. The relevant portions of the Memorandum reads as follows:-

“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."

25. The above must be given harmonious and purposive interpretation that each one of the Clauses under sub-section (1) of Section 36 is independent in its operation and each one of them does not depend upon the other for the extension of the benefit.

26. The learned counsel for the respondent relied on **[2012]18 taxmann.com 129 (HP) Commissioner of Income Tax Vs. H.P.Housing Board**. The facts in that case are as follows:-

"The Assessee-housing board had floated a self financing scheme for sale of houses/flats wherein the allottees were required to deposit some amount with the assessee and construction was to be carried out of these amounts. One of the conditions of the terms of

allotment was that in case the possession of the house/flat was not given to the allottee within a particular time frame, then the assessee-board was liable to pay interest to the allottees on the money received by it. There was delay in construction of the houses and therefore, the Housing Board paid interest at the agreed rate to the allottees in terms of the letter of allotment. The ITO (TDS) held that the amount paid by the assessee to the allottees was in the nature of interest within the meaning of Section 2(28A) and in terms of Section 194A, tax had to be deducted at source. On appeal, the Commissioner (Appeals) allowed the same holding that the amount paid by the Board was not really interest within the meaning of Section 2(28A) but actually compensation for the delay in construction of the house and handing over possession of the same to the allottees. The revenue filed an appeal against the said Judgement, which was dismissed."

27. The High Court of Himachal Pradesh held as follows:-

"8. In the case in hand it stands proved that in case the houses were ready within the stipulated period the Board would not be liable to pay interest. When construction of a house is delayed there can be escalation in the cost of construction. The allottee loses the right to use the house and is deprived of

the rental income from such house. He is also deprived of the right of living in his own house. In these circumstances, the amount which is paid by the Board is not payment of interest but in our view is payment of damages to compensate the allottee for the delay in the construction of his house/flat and the harassment caused to him. It may be true that this compensation has been calculated in terms of interest but this is because the parties by mutual agreement agreed to find out a suitable and convenient system of calculating the damages which would be uniform across the Board for all the allottees.

10. *In the present case the allottees had not given the money to the Board by way of deposit nor had the Board borrowed the amount from the allottees. The amount was paid under a self financing scheme for construction of the flat and the interest was paid on account of damages suffered by the claimant for delay in completion of the flats."*

28. The facts in the present case are distinguishable and different. A provision had been made for deduction of provisions for Bad and Doubtful debts under Section 36(1)(vii)(c) independent of Section 36(1)(viii) which provide for deduction upto 40% for special Reserve created by Assessee providing long term finance for development of infrastructure facility. The Tribunal in the present case had actually not applied its mind on this issue. They had simply reaffirmed the earlier order dated 05.09.2003 for the Assessment Year 2000-2001, and the

order dated 19.01.2004 for the Assessment Year 2001-2002 and followed the same principles. However, as pointed out above, the appeals against the said orders had been allowed by a Co-ordinate Bench of this Court and the answer has been given in favour of the Assessee. If Section 36(1) is examined, it is clear that sub-section (1) gives the list of matters in respect of which deduction can be allowed while computing the income referred under Section 28. Clause (i) to (xi) of sub-section 1 of Section 36 do not imply that those deductions depend on one another. If an Assessee is entitled to the benefit under Clause (i) sub-section (1) of Section 36, the Assessee cannot be deprived of the benefit the other Clauses. This is how the provisions have been arrayed. The computation of amount of deduction under both these clauses has to be independently made without reducing the total income by deduction under clause (viii) of Section 36 of the Act.

29. In view of the above reasons, we hold that this substantial question of law has to be answered in favour of the appellant and against the respondent.

30. Accordingly, both the questions of law framed for consideration are answered in favour of the appellant/Assessee. The Tax Case Appeal is allowed. No costs.

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(V.K., J.) (C.V.K., J.)

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DR.VINEET KOTHARI, J.
and
C.V.KARTHIKEYAN, J.

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Pre-Delivery Judgement made in
Tax Case Appeal No. 939 of 2008

01.03.2019

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