

*** THE HON'BLE THE CHIEF JUSTICE UJJAL BHUYAN**

AND

THE HON'BLE SRI JUSTICE N. TUKARAMJI

+ I.T.T.A.No.144 of 2006

% 04.01.2023

Between:

The Commissioner of Income-Tax-III,
Hyderabad.

Appellant

VERSUS

State Bank of India,
Gunfoundry, Hyderabad.

Respondent

! Counsel for Appellant : Mr. J.V.Prasad

^ Counsel for respondent: Mr. Karthik Ramana Puttam Reddy

<GIST:

> HEAD NOTE:

? Cases referred

¹ (1991) 187 ITR 541 (SC)

² (2003) 264 ITR 545

³ 2009 (316) ITR 291

⁴ (2002) 258 ITR 601 (Bom)

⁵ 2008 (8) TMI 766

⁶ (2000) 241 ITR 374 (Ker)

THE HON'BLE THE CHIEF JUSTICE UJJAL BHUYAN

AND

THE HON'BLE SRI JUSTICE N. TUKARAMJI

I.T.T.A.No.144 of 2006

JUDGMENT: *(Per the Hon'ble the Chief Justice Ujjal Bhuyan)*

Heard Mr. J.V.Prasad, learned Standing Counsel, Income Tax Department for the appellant and Mr. Karthik Ramana Puttam Reddy, learned counsel for the respondent.

2. This is an appeal by the Revenue under Section 260A of the Income Tax Act, 1961 (briefly referred to hereinafter as 'the Act') against the order dated 18.03.2005 passed by the Income Tax Appellate Tribunal, Hyderabad Bench 'B', Hyderabad (briefly referred to hereinafter as 'Tribunal') in ITA No.894/Hyd/2002 for the assessment year 1999-2000.

3. Though by order dated 22.03.2006, the appeal was admitted for hearing, no substantial question of law was framed.

4. However, we find from the appeal memo that appellant has proposed the following questions as substantial questions of law:

- i. Whether on the facts and in the circumstances of the case, Tribunal was justified in holding that interest paid by the assessee on purchase of securities constituting stock-in-trade but paid for the broken period is allowable as a deduction?
- ii. Whether on the facts and in the circumstances of the case, assessee is entitled to claim deduction of interest paid on purchase of securities constituting stock for the broken period till the date of acquisition in terms of Section 37 of the Act?

5. Respondent is an assessee under the Act having the status of a banking company. For the assessment year

1999-2000, it filed return of income declaring taxable income at Rs.136,48,11,053.00. In the course of the assessment proceedings, assessee claimed that it had paid an amount of Rs.51,93,96,305.00 as broken period interest on purchase of securities during the previous year relevant to the assessment year 1999-2000.

6. After hearing the assessee and considering its objection, assessing officer *vide* the assessment order dated 19.03.2002 passed under Section 143(3) of the Act held that claim of the assessee was required to be disallowed in the light of the decision of the Supreme Court in **Vijaya Bank Ltd v. Additional Commissioner of Income Tax, Bangalore**¹ wherein it was held that such an expenditure is required to be capitalized and cannot be allowed as a deduction. Explanation of the assessee that the securities be treated as stock-in-trade thereby treating the broken period interest as revenue expenditure was turned down. Consequently, the

¹ (1991) 187 ITR 541 (SC)

aforesaid amount was added back to the income of the assessee and assessed accordingly.

7. The aforesaid order of the assessing officer was assailed by the assessee before the first appellate authority i.e., Commissioner of Income-Tax (Appeals) IV, Hyderabad (for short, 'CIT(A)' hereinafter). By the order dated 20.08.2002, CIT(A) upheld the order of the assessing officer by relying on the decision of the Supreme Court in **Vijaya Bank Ltd.** (supra 1) holding that expenditure claimed being broken period interest is not allowable as a revenue expenditure.

8. Aggrieved by the aforesaid order, assessee preferred further appeal before the Tribunal.

9. Tribunal framed the question for consideration as under:

Whether broken period interest paid on purchase of securities is revenue expenditure since the securities constitute stock-in-trade?

10. After hearing rival submissions and on perusal of the decision of the Supreme Court in **Vijaya Bank Ltd.** (supra 1), Tribunal noted that the decision of the Supreme Court in **Vijaya Bank Ltd.** (supra 1) was explained by the Central Board of Direct Taxes (for short, 'CBDT' hereinafter). On the same lines, Kerala High Court in **Commissioner of Income Tax v. Nedungadi Bank Ltd.**² distinguished the decision of the Supreme Court in **Vijaya Bank Ltd.** (supra 1), which held that if the securities were held by the banking company as stock-in-trade of the business, interest paid for the broken period would constitute an allowable deduction in the hands of the assessee. Tribunal held that admittedly assessee had purchased the securities to hold them as stock-in-trade. Therefore, the interest paid for the broken period is allowable as a deduction.

11. Mr. J.V.Prasad, learned Standing Counsel, Income Tax Department for the appellant has placed before us the

² (2003) 264 ITR 545

two-Judge Bench decision of the Supreme Court in **Vijaya Bank Ltd.** (supra 1). In that case, assessee had purchased securities. It was contended that the price paid by the securities was determined with reference to their actual value as well as the interest which had accrued on them till the date of purchase. But Supreme Court noted that whatever was the consideration which prompted the assessee to purchase the securities, the price paid for them was in the nature of a capital outlay and no part of it can be set off as expenditure against income accruing on those securities. Relying on the said decision, he further submits that claim for deduction can be sustained only when an assessee is in a position to show that any reasonable expenditure had been incurred for the purpose of realizing the interest on securities.

12. Mr. Prasad has also placed reliance on a decision of the Rajasthan High Court in **Commissioner of Income Tax v. Bank of Rajasthan Limited**³ wherein the question

³ 2009 (316) ITR 291

before the Court was whether taxability of interest on securities subject to transaction price on sale or security continues to be governed by the ratio of the decision in **Vijaya Bank Ltd.** (supra 1). In that case, Rajasthan High Court applied the decision of the Supreme Court and answered the above question in favour of the Revenue. Mr. Prasad submits that ratio laid down by the Supreme Court in **Vijaya Bank Ltd.** (supra 1) still holds the field. Therefore, the questions framed may be answered in favour of the Revenue.

13. *Per contra*, Mr. Karthik Ramana Puttam Reddy, learned counsel for the respondent submits that decision of the Supreme Court in **Vijaya Bank Ltd.** (supra 1) is distinguishable in the facts of the present case. He submits that Bombay High Court in **American Express International Banking Corporation v. Commissioner of Income Tax**⁴ has distinguished the judgment of the Supreme Court in **Vijaya Bank Ltd.** (supra 1) and held in the facts of that case that the

⁴ (2002) 258 ITR 601 (Bom)

Income Tax Department ought to have allowed deduction for the broken period interest paid. According to him, after the decision of the Rajasthan High Court, Supreme Court has delivered a judgment in Civil Appeal No.1549 of 2006, **Commissioner of Income Tax v. Citibank N.A.**⁵ where the question which fell for consideration was whether the interest paid for broken period should not be considered as part of the purchase price but should be allowed as revenue expenditure in the year of purchase of securities? He submits that in the said decision, Supreme Court accepted the distinction pointed out by the Bombay High Court in **American Express International Banking Corporation** (supra 4) and agreed with the view expressed that judgment in **Vijaya Bank Ltd.** (supra 1) would have no application. He therefore submits that appeal by the Revenue has no merit and should be dismissed.

⁵ 2008 (8) TMI 766

14. Submissions made by learned counsel for the parties have received the due consideration of the Court.

15. Issue before the Court is whether broken period interest paid on purchase of securities is revenue expenditure since the securities constitute stock-in-trade?

16. To appreciate the above question, it would be appropriate to first examine the meaning of the expression “broken period interest”. This has been explained by the Bombay High Court in **American Express International Banking Corporation** (supra 4) in the following manner:

“6. Before coming to the facts of the case, a short preface needs to be mentioned. This preface explains the concept of broken period interest. Every bank is required to maintain Statutory Liquidity Ratio (hereinafter referred to as “SLR”). For that purpose, every bank subscribes to Government securities. One such security is known as SGL (Subsidiary General Ledger). This ledger is maintained in the Public Debt Office in the Reserve Bank of India. Every bank is required, as a part of banking business, to subscribe to this loan. This loan/SGL is also transferable like any other security. In this case, for

example, we are concerned with 4.75 per cent. Government of India Loan, 1980, f. v. Rs. 5 lakhs. On the SGL, the Reserve Bank of India pays half yearly interest. In the case of the said 4.75 per cent. Government of India Loan, 1980, f. v. Rs. 5 lakhs, the Reserve Bank of India was required to pay half yearly interest on May 12, 1976, and November 12, 1976. The Reserve Bank of India pays interest on due dates on such securities to the holders of the securities, every six months. The Reserve Bank of India pays interest on the balance to the banks, whose names appear as holders in the PDO ledger. After subscribing to the said loans, the banks were free to transfer such loans for consideration to the other banks. Consequently, the Reserve Bank of India pays interest to the holder on the balances in a security if, in its books, the said security stood in the name of that holder on the due date for payment of interest. As stated above, to maintain SLR levels, every bank subscribes to such loans. This is a part of banking business. However, after so subscribing, the banks are free to deal with such securities like any other trader. Therefore, there are two activities involved--one activity is that of subscribing to the loan and the other is trading. Now, if a bank purchased 4.75 per cent. GOI Loan, 1980, f. v. Rs. 5 lakhs on August 11, 1976, then, on purchase, the said bank was required to lodge the transfer form with the PDO. On such lodgement, the name of the bank was entered in the PDO ledger. Therefore, on the next due date for payment of interest, namely, November 12, 1976,

the bank was entitled to receive half yearly interest from the Reserve Bank of India for the period May 12, 1976, up to November 12, 1976, even though it had bought the said security on August 11, 1976. Therefore, it receives interest for the entire six months, though it bought the security on August 11, 1976. In the above example, since the security was sold/transferred on August 11, 1976 (i.e., after due date for payment of interest), interest had accrued to the transferor/seller from the last due date, i.e., May 12, 1976 up to August 11, 1976.”

17. As explained by the Bombay High Court, every bank is required to maintain a Statutory Liquidity Ratio (SLR). For that purpose, every bank subscribes to government securities. One such security is known as Subsidiary General Ledger (SGL) which is maintained in the Public Debt Office in the Reserve Bank of India. Every bank is required as a part of its banking business to subscribe to this loan. Like any other security, such a loan/SGL is also transferable. Reserve Bank of India pays interest on due dates on such securities to the holders of the securities every six months. After subscribing to the said loans, banks are free to transfer such loans for consideration to other banks.

Reserve Bank of India pays interest to the holder on the balances in a security if in its books the said security stands in the name of that holder on the due date for payment of interest. The above exercise, if we may say so, is a part of the banking business. However, after so subscribing, the banks are free to deal with such securities like any other trader. Therefore, there are two activities involved – one of subscribing to the loan and the other is trading.

18. One of the questions before the Bombay High Court was whether broken period interest payment by the assessee was allowable as a revenue expenditure under the head ‘income from business or profession’? While answering this question, Bombay High Court examined the decision of the Supreme Court in **Vijaya Bank Ltd.** (supra 1).

19. In **Vijaya Bank Ltd.** (supra 1), during the assessment year under consideration, Vijaya Bank had entered into an agreement with Jayalakshmi Bank Ltd. whereby Vijaya Bank took over the liabilities of Jayalakshmi

Bank. It also took over the assets belonging to Jayalakshmi Bank. One of the two items taken over by Vijaya Bank represented interest which accrued on securities taken over by Vijaya Bank from Jayalakshmi Bank. Such amount was brought to tax by the assessing officer under Section 18 of the Act. However, assessee claimed that such amount was deductible under Sections 19 & 20 of the Act. It was in the light of such facts that the decision in **Vijaya Bank Ltd.** (supra 1) was rendered.

20. Therefore, Bombay High Court in **American Express International Banking Corporation** (supra 4), in the facts of that case, held that having assessed the income of the assessee under Section 28 of the Act, Revenue ought to have taxed the broken period interest received but at the same time ought to have allowed deduction for the broken period interest paid.

21. As already noticed above, this decision of the Bombay High Court has found favour with the Supreme Court

in **Citibank N.A.** (supra 5) where Supreme Court agreed with the views expressed by the Bombay High Court. Decision of the Supreme Court in **Citibank N.A.** (supra 5) is dated 12.08.2008 whereas decision of the Rajasthan High Court in **Bank of Rajasthan Limited** (supra 3) is dated 24.03.2008.

22. Before we advert to the facts of the present appeal, we may refer to the decision of the Kerala High Court in **Nedungadi Bank Ltd.** (supra 2). In that appeal, Kerala High Court also examined the effect of the decision of the Supreme Court in **Vijaya Bank Ltd.** (supra 1). Out of the four substantial questions of law which were considered by the Kerala High Court, question No.1 pertained to whether investments made by the assessee in the form of government securities acquired for the purpose of complying with the requirements of the provisions of the Banking Regulation Act i.e., to maintain SLR, could be treated as trading asset/stock-in-trade of the business of the assessee? The 4th question considered by the Kerala High Court was as to whether

interest paid for the broken period in the purchase of securities is an allowable deduction? Referring to the Circular dated 24.04.1991 issued by the CBDT, Kerala High Court held that securities held by banks constitute their stock-in-trade or investment and consequently loss claimed by banks on the valuation of their securities should be allowed as a deduction in computing the taxable profits. Therefore, Kerala High Court confirmed the view taken by the Tribunal that securities held by the assessee bank were stock-in-trade of the business of the assessee bank and that the notional loss suffered on account of revaluation of the said securities at the close of the year was an allowable deduction in the computation of profits of the assessee bank. Finally, in respect of the 4th question as to whether the Tribunal was justified in allowing the claim for deduction of interest paid for the broken period for acquisition of the securities till the date of such securities, Kerala High Court held that the said question was squarely covered by its earlier decision in **Commissioner of Income Tax v. South Indian**

Bank Ltd.⁶ wherein it was held that interest paid for the broken period would constitute allowable outgo in the hands of the assessee and was an admissible deduction in the computation of total income of the assessee (bank) under the head 'profits and gains of business or profession'.

23. Adverting to the facts of the present case, we find that it is the contention of the respondent that respondent had been holding its securities all along as stock-in-trade which is not in dispute. For successive assessment years, Revenue has accepted the fact that respondent had been holding the securities as stock-in-trade. Circular No.665 dated 05.10.1993 of the CBDT has clarified the decision of the Supreme Court in **Vijaya Bank Ltd.** (supra 1). CBDT has clarified that where the banks are holding securities as stock-in-trade and not as investments, principles of law enunciated in **Vijaya Bank Ltd.** (supra 1) would not be applicable. Therefore, CBDT has clarified that assessing officer should

⁶ (2000) 241 ITR 374 (Ker)

determine on the facts and circumstances of each case as to whether any particular security constitute stock-in-trade or investment taking into account the guidelines issued by Reserve Bank of India from time to time.

24. It is in the above back drop that Tribunal has held that the respondent had purchased securities to hold them as stock-in-trade. Therefore, interest paid on such securities would be an allowable deduction.

25. We are in agreement with the finding returned by the Tribunal. That apart, this is a finding of fact rendered by the Tribunal and in an appeal under Section 260A of the Act, we are not inclined to disturb such a finding of fact, that too, when the legal position is very clear.

26. For the aforesaid reason, we answer the above questions in favour of the respondent assessee and against the appellant Revenue.

27. Appeal is accordingly dismissed. However, there shall be no order as to costs.

28. As a sequel, miscellaneous applications pending, if any, in this Writ Appeal, shall stand closed.

UJJAL BHUYAN, CJ

N.TUKARAMJI, J

Date: 04.01.2023
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