IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 20-01-2026

CORAM

THE HON'BLE DR.JUSTICE ANITA SUMANTH

AND

THE HON'BLE MR.JUSTICE MUMMINENI SUDHEER KUMAR

TCA No.167 of 2013

M/s IDFC Limited
KRM Towers, 8th Floor, No.1, Harringon Road,
Chetpet, Chennai – 600 031.

..Appellant

Vs

The Assistant Commissioner Of
Income Tax, Company Circle II(3), Chennai.

..Respondent

Prayer: Appeal filed under Section 260A of the Income Tax Act, 1961 against Income Tax Appeal No.99/Mds/2012 dated 28.09.2012 on the file of the Income Tax Appellate Tribunal, Chennai "C" Bench for the assessment year 2005 – 2006.

For Appellant(s): Mr.Niraj Sheth

For Respondent(s): Mr.T.Ravikumar
Senior Standing Counsel

JUDGMENT

(Judgment of the Court was delivered by Dr.Anita Sumanth J.)

This Tax Case (Appeal) relating to assessment year 2005-06 has been filed at the instance of the assessee, assailing order dated 28.09.2012 passed by the Income Tax Appellate Tribunal (in short 'ITAT"/'Tribunal').

2. We have heard the detailed submissions of Mr.Niraj Sheth, learned counsel appearing for Mr.O.R.Santhanakrishnan, learned counsel on record for the appellant/assessee and Mr.T.Ravikumar, learned Senior Standing Counsel appearing for the respondent/revenue.

3. The substantial questions of law that had been admitted on 19.06.2013 are taken up for consideration in seriatim. The first and second substantial questions of law 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 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 receipts fell within the definition of "interest" in Section 2(28A) of the Act?*

4. The above questions were raised for consideration in T.C.(A)Nos.1288 and 1290 of 2007 relating to assessment year 2000-01 and 2001-02 and have been answered in favour of the assessee as follows:

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 3 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?"*

…………..

8. ………. 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 5 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 cooperative bank from investments made on or after the 1 st day of June, 1998 by way of shares or longterm 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 6 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 7 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 1 st 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 8 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 9 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 10 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.

5. The above decision, we are told, has attained finality and hence, in light of the above discussion, substantial questions of law Nos.1 and 2 are answered in favour of the assessee.

6. The third substantial question of law reads as follows:

3. Without prejudice to above and in the alternative whether on the facts and in the circumstances of the case, the Tribunal ought to have held that the Liquidated Damages (in its entirety) were eligible for deduction under Section 36(1)(viii) of Act since the above amounts were earned from long term finance provided to infrastructure enterprises and in the event the income derived from such long term finance was not treated as "interest" eligible for exemption under Section 10(23G), the same were "profit" derived from business of long term finance of infrastructure facility and hence eligible for deduction under Section 36(1)(viii)?

7. Since the appellant has succeeded in regard to issues arising in substantial questions 1 and 2, learned counsel on record for the appellant makes an endorsement not pressing substantial question of law No.3, but seeking liberty to revive the same, if necessary, at a future point in time. Recording the

endorsement and granting liberty as sought, this substantial question of law is returned as unanswered.

8. Substantial question of law Nos.4 and 5 read as follows:

> *4. 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?*
>
> *5. Whether the Income Tax Appellate Tribunal ought to have held that the deduction to which the appellant was entitled under Section 36(viia)(c) of the Act was to be granted to it without reducing, from the appellant's income, the deduction to which the appellant was entitled under Section 36(1)(viii) of the Act?*

9. We have had occasion to consider the aforesaid issue in respect of the very same assessee for assessment year 2007-08 in T.C.(A)No.169 of 2013 dated 20.01.2026 and have answered the same in favour of the appellant after referring to the discussion and conclusion in T.C.(A)Nos.1288 and 1290 of 2007. The relevant portion of the judgment reads as follows:

> *2. The substantial questions of law that had been admitted on 19.06.2013 are as follows:*
>
> *1. 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?*

2. Whether the Income Tax Appellate Tribunal ought to have held that the deduction to which the appellant was entitled under Section 36(viia)(c) of the Act was to be granted to it without reducing, from the appellant's income, the deduction to which the appellant was entitled under Section 36(1)(viii) of the Act?

3. We have heard the detailed submissions of Mr.Niraj Sheth, learned counsel appearing for Mr.O.R.Santhanakrishnan, learned counsel on record for the appellant/assessee and Mr.T.Ravikumar, learned Senior Standing Counsel appearing for the respondent/revenue.

4. We find that the issue stands squarely covered by two decisions of two different Division Benches of this Court in the assessee's own case for assessment years 2000-01, 2001-02 and 2002-03 in T.C.(A) Nos.1288 and 1290 of 2009 dated 08.09.2015 and T.C.(A)No.939 of 2008 dated 01.03.2019 respectively.

5. Hence, it would suffice for us to extract the discussion and reasoning in order dated 08.09.2015, which is the first order on this issue and as we concur with the same.

> *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 (vii) 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.

6. We are given to understand that the above decision has not been challenged by the revenue and has attained finality. Based on the above reasoning, this Tax Case (Appeal) is allowed answering the substantial questions of law in favour of the assessee and against the Revenue. No costs.

10. In light of the above, these substantial questions of law are answered in favour of the assessee.

11. Substantial question of law Nos.6 and 7 read as follows:

> *6. Whether the Income Tax Appellate Tribunal ought to have held that 3% of the income eligible for claiming deduction under Section 36(1)(viii) could be reasonably attributed towards administrative expenses?*
>
> *7. Whether the Income Tax Appellate Tribunal erred in dismissing the ground in relation to reversal of the suo moto disallowance of interest expense incurred for earning income exempt under Section 10(34) amounting to Rs.8,30,51,276 made by the appellant even though for the earlier years the matter was remitted back to the Assessing Office to determine whether the investments were made by the assessee from own funds or borrowed funds.?"*

12. Learned counsel for the appellant makes an endorsement not pressing these substantial questions of law, recording which, these substantial questions of law are returned unanswered.

13. This Tax Case (Appeal) is disposed as above. No costs.

(A.S.M.,J.) **(M.S.K.,J.)**

20-01-2026

Index: Yes/No
Speaking order
Neutral Citation: Yes

sl

To

1. The Assistant Commissioner Of
   Income Tax, Company Circle II(3), Chennai.

2. The Income Tax Appellate Tribunal, Chennai "C" Bench, Chennai.

DR.ANITA SUMANTH J.

AND

MUMMINENI SUDHEER KUMAR J.

sl

TCA No.167 of 2013

20-01-2026