(2011) 05 P&H CK 0053

In the Punjab And Haryana At Chandigarh

Case No : Interest-Tax Appeal No. 1 of 2006 A.Y. 1998-99

CIT APPELLANT

Vs

Haryana Financial Corporation RESPONDENT

Date of Decision : 26-05-2011

Acts Referred:

Income Tax Act, 1961 — Section 11(5), 13(1), 2(28A), 2(5), 2(7)
Reserve Bank of India Act, 1934 — Section 42, 42(1B)

Citation : (2011) 05 P&H CK 0053

Hon'ble Judges : A.K. Goel, Acting C.J.;Ajay Kumar Mittal, J

Bench : Division Bench

Final Decision : Dismissed

Judgement

Ajay Kumar Mittal, J.—This appeal has been filed by the Revenue u/s 21 of the Interest-Tax Act, 1974 (in short ""1974 Act"") read with

section 260A of the IT Act, 1961 (hereinafter referred to as ""the Act"") against the order dated 31st March, 2005 passed by the income tax

Appellate Tribunal, Chandigarh Bench ""A"", Chandigarh (for short ""the Tribunal"") in Interest-Tax Appeal No. 7/Chd/2002, relating to the asst. yr.

1998-99.

2. The appeal was admitted by this Court vide order dated 20th Nov., 2007 for determination of the following substantial question of law :

Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the Revenue authorities were not justified in

including the sum of Rs. 1,99,89,630 being interest-Tax recovered from the customers as chargeable to interest-Tax ?

3. Briefly stated, the facts necessary for adjudication as narrated in the appeal are that the assessee is a credit institution earning- interest and filed

its return of chargeable interest on 30th Nov., 1998 declaring total chargeable interest at Rs. 99,94,82,400. The assessee had not included the

interest-Tax amounting to Rs. 1,99,89,630 collected from its clients in the chargeable interest. The assessing officer vide order dated 23rd Jan.,

2001 completed the assessment u/s 8(2) of the 1974 Act while adding the said amount of Rs. 1,99,89,630 to the chargeable interest in view of

provisions of section 26C of the 1974 Act. Feeling aggrieved, the assessee filed an appeal before the Commissioner of income tax (Appeals) (in

short ""the Commissioner(Appeals)""). The Commissioner(Appeals) vide order dated 16th April, 2002 upheld the order of the assessing officer and

dismissed the appeal. Dissatisfied with that, the assessee approached the Tribunal who vide order dated 31st March, 2005 allowed the appeal

holding that the amount of Rs. 1,99,89,630 being interest-Tax recovered from the customers was not chargeable to interest-Tax. Hence, the

present appeal by the Revenue.

4. We have heard learned counsel for the parties and have perused the record with their assistance.

5. The solitary issue involved in this appeal is whether the amount of interest-Tax which was recovered by the assessee from its customers was

chargeable to interest-Tax under the provisions of the 1974 Act.

6. Learned counsel for the Revenue submitted that the controversy involved herein falls under the provisions of section 26C of the 1974 Act and

the interest-Tax received by the assessee was chargeable interest u/s 2(5) of the 1974 Act. It was contended that the credit institutions had the

power to vary terms of any agreement entered with its borrowers. In such a situation, the interest-Tax levied subsequently could be recovered

from the borrowers. According to the learned counsel, the assessee was, thus, liable to pay interest-Tax on such amount as well. Learned counsel

sought to draw support from the following observations in the judgment of the Hon''ble Supreme Court in Indian Banks'' Association, Bombay and

Others Vs. Devkala Consultancy Service and Others,

Section 26C of the Interest-Tax Act, 1974, providing that it shall be lawful for credit institutions to increase the agreed rate of interest from

borrowers to the extent of their interest-Tax liability, is an enabling provision. It has to be construed having regard to the term lawful used therein.

The section merely prevails over an agreement under which any term loan has been sanctioned by the credit institution before 1st Oct., 1991. It

would be lawful for the credit institution to vary the agreement as regards rate of interest only for the purpose of recovering the amount of interest-

Tax payable by the credit institution, and, a fortiori, nothing over and above the same. Such increase in the rate of interest would be (a) to the

extent to which such institution is liable to pay the interest-Tax; (b) in relation to the amount of interest on the term loan; and (c) which is due to the

credit institution.

Increase in the rate of interest in terms of section 26C has a direct nexus with the statutory impost of interest-Tax. Since increase in interest in a

justifiable manner pertains to passing on the burden of interest-Tax, it cannot be claimed that the increase in interest is done in the exercise of the

contractual right of credit institution to increase the rate of interest. Nothing can be realised by way of tax or burden akin thereto which has not

been authorized by Parliament.

7. Controverting the aforesaid submission, learned counsel for the assessee vehemently submitted that the Tribunal was right in holding that the

interest-Tax was not includible in the chargeable interest on which tax could be levied under the 1974 Act. He submitted that similar issue was

considered in Commissioner of Income Tax Vs. Bank of Madura Ltd., in favor of the assessee. Reference was also made to the judgments of

Madhya Pradesh High Court in Commissioner of Income Tax Vs. State Bank of Indore, , Commissioner of Income Tax Vs. Canara Bank, and

Bombay High Court in Commissioner of Income Tax Vs. United Western Bank Ltd.,

8. We find substantial force in the submission made by the learned counsel for the assessee.

9. The 1974 Act was enacted by Parliament with effect from 1st Aug., 1974, with an object of imposing tax on the total amount of interest

received by scheduled banks/credit institutions on loans and advances. It, however, was withdrawn in the year 1978, but reintroduced in the year

1980, where after it was again withdrawn in the year 1985. The said tax, however, was reintroduced with effect from 1st Oct., 1991, by reason of

the Finance (No. 2) Act, 1991.

10. It would be expedient to refer to the relevant provisions of the 1974 Act.

Section 2(5) of the 1974 Act defines ""chargeable interest"" and

section 2(7) ""interest"" as under :

2(5). Chargeable interest means the total amount of interest referred to in section 5, computed in the manner laid down in section 6.

2(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 (IB) of section 42 of the RBI Act, 1934;

(ii) discount on treasury bills.

11. Section 4 is the charging section and provides for charge of interest-Tax, as under :

(1) Subject to the provisions of this Act, there shall be charged on every scheduled bank for every assessment year commencing on or after the 1st

day of April, 1975, a tax in this Act referred to as interest-Tax in respect of its chargeable interest of the previous year @ seven per cent of such

chargeable interest:

Provided that the rate at which interest-Tax shall be charged in respect of any chargeable interest accruing or arising after the 31st day of March,

1983 shall be three and a half per cent of such chargeable interest.

(2) Notwithstanding anything contained in sub-section (1) but subject to the other provisions of this Act, there shall be charged on every credit

institution for every assessment year commencing on and from the 1st day of April, 1992, interest-Tax in respect of its chargeable interest of the

previous year @ three per cent of such chargeable interest:

Provided that the rate at which interest-Tax shall be charged in respect of any chargeable interest accruing or arising after the 31st day of March,

1997, shall be two per cent of such chargeable interest.

12. Section 5 deals with the scope of chargeable interest whereas section 6 relates to computation of chargeable interest, which read thus :

5. Scope of chargeable interest-Subject to the provisions of this Act, the chargeable interest of any previous year of a credit institution shall be the

total amount of interest other than interest on loans and advances made to other credit institutions or to any co-operative society engaged in

carrying on the business of banking accruing or arising to the credit institution in that previous year :

Provided that any interest in relation to categories of bad or doubtful debts referred to in section 43D of the IT Act shall be deemed to accrue or

arise to the credit institution in the previous year in which it is credited by the credit institution to its P&L a/c for that year or, as the case may be, in

which it is actually received by the credit institution, whichever is earlier.

6. Computation of chargeable interest.--(1) Subject to the provisions of sub-section (2), in computing the chargeable interest of a previous year,

there shall be allowed from the total amount of interest other than interest on loans and advances made to credit institutions accruing or arising to

the assessee in the previous year, a deduction in respect of the amount of interest which is established to have become a bad debt during the

previous year :

Provided that such interest has been taken into account in computing the chargeable interest of the assessee of an earlier previous year and the

amount has been written off as irrecoverable in the accounts of the assessee for the previous year during which it is established to have become a

bad debt.

Explanation.--For the removal of doubts, it is hereby declared that in computing the chargeable interest of a previous year, no deduction, other

than the deduction specified in this sub-section, shall be allowed from the total amount of interest accruing or arising to the assessee.

(2) In computing the chargeable interest of a previous year, the amount of interest which accrues or arises to the assessee before the 1st day of

August, 1974 or during the period commencing on the 1st day of April, 1985 and ending with the 30th day of September, 1991 shall not be taken

into account.

13. Section 2(5) of the 1974 Act defines ""chargeable interest"". According to it, chargeable interest is the total amount of interest referred to in

section 5, computed in the manner laid down in section 6. Section 2(7) defines ""interest"". Interest means interest on loans and advances made in

India and includes (a) commitment charges on the 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 in section 42(1B) of the RBI Act, 1934;

and (ii) discount on treasury bills. Section 4 deals with charge of interest-Tax. Section 5 relates to the scope of chargeable interest as the total

amount of interest (other than interest on loans and advances made to scheduled banks) accruing or arising to the bank or credit institution in that

previous year. Section 6 is the computation section providing for determining the total assessable interest for levy of interest-Tax. A combined

reading of the aforesaid provisions shows that it is only the chargeable interest on which interest-Tax is payable by a credit institution under the

1974 Act.

14. We now proceed to refer to section 26C of the 1974 Act on which the Revenue had placed heavy reliance. Section 26C defines powers of

credit institutions to vary agreement in the following terms :

26C. Power of credit institutions to vary certain agreements.-- Notwithstanding anything contained in any agreement under which any term loan

has been sanctioned by the credit institution before the 1st day of October, 1991,. it shall be lawful for the credit institution to vary the agreement,

so as to increase the rate of interest stipulated therein to the extent to which such institution is liable to pay interest-Tax under this Act in relation to

the amount of interest on the term loan which is due to the credit institution.

Explanation.--For the purposes of this section, term loan means a loan which is not repayable on demand.

15. Elaborating the scope of section 2(7) and 26C of the 1974 Act, the Bombay High Court in United Western Bank Ltd.s case (supra), following

its earlier judgment in the case of Unit Trust of India and Another Vs. P.K. Unny and Others, had concluded as follows :

As stated in our judgment in the case of Unit Trust of India v. P.K Unny (supra), the Interest-Tax Act was enacted as an anti-inflationary measure

and also to augment revenues. The Act has been brought into force in 1974 and, thereafter, it was intermittently dropped and revived. The Act

was meant to discourage borrowings. Between the period 1974 to 1992 interest rates in India were centrally administered. However, after 1992,

interest rates are decided by market forces. Even the Government was required to borrow at market rates. After 1992-93, the Government is the biggest borrower. Therefore, the Interest-Tax Act is in force intermittently. u/s 26C of the Interest-Tax Act, the lender is empowered to modify the

terms of the loan agreement so as to pass the burden on to the borrower which itself shows that the Act applies strictly to loans and advances and

not to investments. Section 26C also indicates that the Interest-Tax Act is a special tax. That, it provides for an indirect levy on the borrowers.

That, if the argument of the Department was to be accepted, the object of the Act would fail because whenever the bank subscribes to

Government securities, the borrower is the Government and if the Act is applicable, u/s 26C the lender would insist on the Government paying

interest-Tax which would not only defeat anti-inflationary measure but, it would also decrease the Government revenues. Therefore, one has to

keep in mind the object and the scheme of the Act while interpreting section 26C of the Interest-Tax Act. The difference between loan and

investments is well-known in a commercial sense, accounting sense and also under the Companies Act (see section 370 and 372). It is also borne

out by section 13(1)(d) and section 11(5) of the IT Act. It is also borne out by section 2(28A) of the IT Act and section 2(7) of the Interest-Tax

Act. Therefore, we hold that the Interest-Tax Act will not apply to interest'' received by the assessee-bank on securities/debentures held by the

assessee under the category permanent.

16. Section 26C of the 1974 Act empowers a credit institution to vary terms of agreement with the borrowers to the extent of liability of interest-

Tax under the 1974 Act, where the term loan had been sanctioned prior to 1st Oct., 1991. The ultimate destination of interest-Tax collected by

the assessee under the 1974 Act is the Government treasury and no benefit accrues to the assessee. The receipt is in fact interest-Tax on interest

and is not in the nature of chargeable interest. Therefore, the interest-Tax which is collected by assessee cannot partake the character of

chargeable interest which is in addition to interest paid by the customer to the assessee and no interest-Tax would be exigible on it.

17. The Madras High Court in Bank of Madura Ltd.s case (supra) delving into identical issue involved herein, after considering the judgments in

State Bank of Indore (supra) and Canara Banks case (supra) had held that interest-Tax recovered from the borrowers by the credit institutions was not to form part of interest/chargeable interest which would be exigible to interest-Tax. It was observed as under :

The amount of seven per cent collected from the borrowers is for the purpose of paying tax under the Interest-Tax Act. In fact, the collection of

these amounts has no nexus with the amount advanced by the assessee-bank to its borrowers. In reality, it is interest on interest. It is stated that

there is an oral contract between the borrowers and the bank for the payment of seven per cent on the borrowed amount. The amount collected at

seven per cent by the bank was paid as tax under the Interest-Tax Act, 1974. The assessee-bank is also offering this seven per cent collection for

income tax purposes and income tax was levied thereon. The assessee-bank has to pay advance tax every three months. Therefore, the amount

collected by the assessee-bank, though it reached its hands, ultimately went into the coffers of the Government. The assessee-bank is not

appropriating the said amount for its own benefit. Under the law there is no prohibition for such collection. Thus, considering the facts arising in this

case in the light of the judicial pronouncements cited supra, we hold that the Tribunal was correct in holding that seven per cent amount collected

by the assessee-bank would not fall under the definition of interest as stated in section 2(7) of the Interest-Tax Act.

18. Accordingly, the substantial question of law is answered against the Revenue and in favor of the assessee. The appeal stands dismissed.

