

**(1998) 12 KAR CK 0015**  
**In the Karnataka High Court**  
**Case No : Writ Petition No. 3927 of 1994**

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|-----------------------------------------|------------|
| Devkala Consultancy Services, Bangalore | APPELLANT  |
| Vs                                      |            |
| Union of India and Others               | RESPONDENT |

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**Date of Decision :** 18-12-1998

**Acts Referred:**

Banking (Regulation) Act, 1949 — Section 21, 21 (2) (e), 35 A, 36 (1) (a)  
Constitution of India, 1950 — Article 226, 265  
Interest Tax Act, 1974 — Section 26 C

**Citation :** AIR 1999 Kar 319 : (1999) 2 KarLJ 115

**Hon'ble Judges :** R.P. Sethi, C.J.; Mohamed Anwar, J

**Bench :** Division Bench

**Advocate :** Sri P.S. Rajagopal, for the Appellant; Sri S. Ramaswamy Iyengar, Sri S.V. Hegde Mulkdhand and Sri S.G. Hegde, Advs. and Sri N. Narasimha Murthy, Senior Advocate for Sri E.S. Kiresur, for the Respondent

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## Judgement

R.P. Sethi, C.J.—Invoking the jurisdiction of this Court under Article 226 of the Constitution of India, the petitioner a partnership firm claiming to be engaged in assisting the banking public has filed this petition in public interest praying to declare that the action of the respondent-Banks in rounding up interest rates to the next higher 0.25% is illegal, arbitrary and untenable. It is further prayed that respondents be commanded to refund the excess interest collected from the borrowers as result of the rounding up to the next higher 0.25% for which respondent 2 be commanded to direct all the Scheduled Commercial Banks to refund the alleged excess interest collected from the borrowers.

2. It is submitted that respondents 3 to 29, which are all banks, operating in the country were charging interest on loans and advances granted to the public at a rate which was in excess of what is permitted under the provisions of the Interest-tax Act, 1974 (hereinafter referred to as the "Interest-tax Act") and the directions issued by the second respondent u/s 21 of the Banking Regulation Act, 1949 (hereinafter referred to as the "Banking Regulation Act"). The alleged illegal collection is stated to have been continued solely on the basis of a decision

taken by respondent 30, an Association of the Indian Banks.

It is contended that respondent 3 is a Banking Company established under the provisions of the State Bank of India Act, 1955; respondents 4 to 10 are the Banking Companies established under the State Bank of India (subsidiary Banks) Act, 1959, and respondents 11 to 29 are stated to be Banking Companies established under the provisions of Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, and Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980. In this way, respondents 3 to 29 are stated to be the instrumentalities of the State amenable to writ jurisdiction of this Court.

The provisions of the Interest-tax Act are stated to have been re-introduced with effect from 1-10-1991 by virtue of the Finance Act, 1991. Section 4 of the said Act provides that the bank shall charge for every assessment year commencing on and from 1st day of April 1992, the interest-tax in respect of its chargeable interest of the previous year at the rate of 3% of such chargeable interest. The said Act further provides that notwithstanding anything contained in any agreement under which any term loan is sanctioned, it shall be lawful for the credit institution to the agreement to which such institution is liable to pay the interest-tax under the Act in relation to the amounts on the term loan which is due to the credit institution. While imposing the tax of 3% on the interest earned by the banks, they were permitted to enhance the rate of interest to the consumers to the extent of 3% on interest on the term loans. Under the directions issued by the Reserve Bank of India, the other banks were allowed to enhance the rate of interest by 3% of the interest rates, which were in operation prior to 1-10-1991. In pursuance to the directions issued by the Reserve Bank of India, all the banks are stated to have issued directives to their branches to debit to each borrowal account tax at the flat rate of 3% of the interest arising or accruing to the bank from 1-10-1991. It is alleged that totally ignoring the provisions of the Interest-tax Act and the instructions issued by the Reserve Bank of India, the respondent 30 vide its communication addressed to all respondents-Banks advised that the rate of interest be loaded with the interest tax of 3% and rounded upto the higher 0.25%. In this way, the banks charged penal interest of 2% on the amounts in defaults in respect of loans and advances and the cum-tax penal interest in that event is rounded to be 2.06%, with the result, that small borrowers, agriculturists, artisans, small industries, self-employed and other weaker sections of the society are subjected to illegal losses and burden. The banks are alleged to be illegally enriching themselves.

It is contended that u/s 26-C of the Interest-tax Act, the banks can increase rate of interest chargeable on loans and advances only to the extent to which they are liable to pay the interest-tax and the action of the respondents in rounding it up to the next higher 0.25% is resulting in actual increase of interest rate much beyond the permissible limits. Collection of such an interest is stated to be arbitrary, unfair, unjust amounting to illegal enrichment and unlawful gains by the banks. The rounding up the cum-tax interest to the next higher 0.25% solely

based on the decision of respondent 30 is stated to be without the authority of law and not referable to any statutory sanction. The action of the respondents has been termed to be amounting to unfair trade practice, exploitation by misusing monopolistic power, contrary to the statutory directives issued by the Reserve Bank of India, contrary to and violative of Section 26-C of the said Act, opposed to the public policy and detrimental to public interest, which cannot be sustained in law. The directions adopted by the banks are claimed to be in violation of the provisions of Articles 14 and 21 of the Constitution of India.

3. In the statement of objections filed, respondent 30 has submitted that respondents 3 to 29 are its members. Respondents 3 to 29, which are credit institutions within the meaning of Section 5-A of the Interest-tax Act are liable to pay tax in respect of their chargeable interest of the previous year at the rate of 3% of such chargeable interest. The banks are claimed to have been authorised to increase the rate of interest under the provisions of Section 26-C of the Interest-tax Act. The aforesaid section is claimed to have been inserted in the statute book by Finance Act, 1991 with effect from 1-10-1991. As a result of the aforesaid provision, the respondent 2 is admitted to have issued instructions on 2-9-1991 advising respondents 3 to 29 to pass on the incidence of interest-tax, pro rata to their borrowers, irrespective of the category of borrowers and types of advances and to follow an uniform practice in that regard. After receipt of the aforesaid directions of the Reserve Bank of India, intimation was given to respondents 3 to 29 to increase the rate of interest as empowered u/s 26-C of the Interest-tax Act. The respondent submits that it has neither violated the provisions of the said Act nor the directions of respondent 2. It has only worked out the increase in the rate of interest as a measure for reimbursements of interest-tax liability to be borne, by the banks under the provision of Section 4 of the said Act. It is further submitted that tax of 3% is on the gross interest income earned by the banks, the liability of which is passed on to the borrower in terms of the provisions of Section 26-C of the Interest-tax Act. It is further contended that the rounding off to a figure of 0.25% is a recognised practice in banking, which does not result in alleged unjust enrichment of the banks. None of the respondents is stated to be indulging in any unfair trade practice. The petition is claimed to be misconceived, which deserved dismissal.

In the statement of additional objections filed by respondent 30 it is submitted that vide Annexure-R-A4, the Reserve Bank of India has approved the action of respondent 30, which is in conformity with the powers of respondent 2 to advise the banks under the provisions of Section 21(2)(e) read with Sections 35A and 36(1)(a) of the Banking Regulations Act. The increase of interest is stated to be very marginal and not excessive. The payment of interest is claimed to be purely a matter between the bank and the borrower based upon contract entered into between the two, which cannot be questioned by a third person by way of writ filed under Article 226 of the Constitution of India. It is submitted that since it was extremely cumbersome, difficult and impracticable to work out the exact interest-tax component in respect of each borrower after adding the interest tax

component, the rates of interest worked out by the respondent as a result of the incidence of interest-tax at 3% under the Interest-tax Act by taking the cum-tax interest rates in steps of higher 0.25% was resorted which is sound and legal.

4. We have heard the learned Counsel for the parties and perused the record.

5. The Interest-tax Act was enacted to impose a special tax on the total amount of interest received by the scheduled banks on loans and advances made in the country. Section 4 of the said Act provided that subject to the provisions of the 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 known as interest-tax in respect of its chargeable interest of the previous year at the rate of 3% of such chargeable interest. It is not disputed that the aforesaid provision was made effective in operation from 1-10-1991. u/s 5 of the said Act the chargeable interest of any previous year of a scheduled bank is deemed to be the total amount of interest accruing or arising to the bank in that previous year. It follows, therefore, that the tax sought to be imposed by the said Act was a tax on the banks and not upon the borrowers. Under the said Act the banks were obliged to pay the tax on the interests in terms of and to the extent provided under Sections 4 and 5.

6. Section 26-C was inserted later authorising the banks to vary the agreements executed between the credit institutions and the borrowers so as to increase the rate of interest stipulated therein to the extent to which such institution was liable to pay the interest-tax under the Act in relation to the amount of interest on the term loan which was due to the credit institution. Respondents 3 to 29 are admittedly the credit institution and authorised to vary the terms of the agreement, so as to increase the rate of interest to the extent the same is payable by such credit institutions. It follows, therefore, that but for Section 26-C, none of the respondents or any other bank could put a burden upon the borrower by varying the terms of the agreement so as to increase the rate of interest for the purposes of liquidating their liability imposed u/s 4 and 5 of the Interest-tax Act. It is not disputed that respondent 30 issued a circular dated 9-10-1991 intimating all its Member Banks regarding the rates of interest after loading with the interest-tax of 3% under the Interest-tax Act vide Annexure-R-A2, the relevant portion of which is reproduced hereunder:

"The Reserve Bank of India (RBI) vide its Circular DBOD No. BP. BC. 20/C. 469(1)-91, dated 2nd of September, 1991, has advised the banks in the matter of levy of interest-tax w.e.f. 1-10-1991. Banks have also been advised to follow a uniform practice in consultation with the Indian Banks' Association."

The Managing Committee has, at its meeting on 7th October, 1991, decided that the rates of interest might be loaded with the interest-tax of 3% and rounded upto the higher 0.25%. Accordingly, rates from 2%-30% have been worked out and are shown in the enclosure. Member banks may apply uniformly, the cum-tax interest rates as shown in the enclosure and pass on the incidence of the

interest-tax, pro rata, to their borrowers, irrespective of the category of borrowers and types of advances, as indicated in the above RBI circular".

The aforesaid letter is not referable to any statutory authority or sanction. Respondent 30 admittedly had no power to issue directions under the guise of "advise" directing the banks to round up the interest upto the higher 0.25%. The aforesaid Annexure having no sanction of law and issued by an authority not empowered under any statute could not be made the basis for burdening the borrowers and subjecting them to pay the tax in excess of what was sanctioned u/s 26-C of the Interest-tax Act.

7. The learned Counsel appearing for the respondents have tried to justify Annexure-R-A2 with the aid of the letter of Reserve Bank of India Annexure-R-A4, by which the Chairman of respondent 30 was intimated:

"Please refer to your letter No. OPR/10-90-A/6846 dated 4-2-1993, on the above subject addressed to Shri D.R. Mehta, our Deputy Governor. In view of the position stated therein, on practical consideration, we agree with your views.

(emphasis supplied)

8. The letter of the Reserve Bank of India has been tried to be justified with the aid and assistance of Section 35A of the Banking Regulation Act, which reads as under:

"Power of the Reserve Bank to give directions.--(1) Where the Reserve Bank is satisfied that -

(a) in the public interest; or

(aa) in the interest of banking policy; or

(b) to prevent the affairs of any banking company being conducted in a manner detrimental to the interests of the depositors or in a manner prejudicial to the interests of the banking company; or

(c) to secure the proper management of any banking company generally,

it is necessary to issue directions to banking companies generally or to any banking company in particular, it may, from time to time, issue such directions as it deems fit, and the banking companies or the banking company, as the case may be, shall be bound to comply with such directions.

(2) The Reserve Bank may, on representation made to it or on its own motion, modify or cancel any direction issued under sub-section (1), and in so modifying or cancelling any direction may impose such conditions as it thinks fit, subject to which the modification or cancellation shall have effect".

"The Reserve Bank is entitled to give directions to bankers u/s 20(3) of the Foreign Exchange Regulation Act, 1947, blocking certain accounts. Section 20(3) does not contemplate the issue of a prior notice before taking such action under

that section -- Mohamed Ayisha Nachiyar v Deputy Director, Enforcement.

Directions by Reserve Bank cannot prevent payment of higher bonus in terms of the agreement. American Express International Banking Corporation v S. Sundaram".

It is further submitted that the Reserve Bank had the jurisdiction u/s 36(1)(a) to caution or prohibit banking companies generally or any banking company in particular against entering into any particular transaction or class of transactions, and generally give advice to any banking company. A perusal of Annexure-R-A4, the letter of the Reserve Bank of India when examined in the context of Section 35A read with Section 36(1)(a) cannot be held to be the exercise of power by the Reserve Bank as contemplated under the aforesaid provisions. The letter only obliges respondent 30 by showing agreement with their views. Exercise of power u/s 35A or Section 36(1)(a) contemplates conscious action based upon deliberations keeping in view the public interest and the interest of the banking company. The letter relied upon by the respondents does not reflect or even indicate the satisfaction of the Reserve Bank in terms of the provisions of Section 35A of the Banking Regulation Act.

9. The Dictionary meaning of the word "satisfaction" is the act of satisfying or the state or feeling of being satisfied and the action of satisfaction contemplates adequate deliberation for acceptability of the conclusions. In other words, it means that before recording satisfaction, the concerned authority must be convinced or persuaded to come to the conclusion. Applying any test it cannot be said that the order Annexure-R-A4 was an order issued by the Reserve Bank under the aforesaid provisions of the Banking Regulation Act. We, therefore, declare that the action of respondent 30 in issuing the circular Annexure-R-A2 is without jurisdiction, which is non est and not binding upon the banks. None of the banks could therefore act upon the aforesaid circular and charge additional tax by rounding up to higher 0.25%. The aforesaid Annexure is, therefore, quashed with declaration that it shall not be deemed to have any effect on the right or interests of any borrower of the bank.

10. The learned Counsel appearing for the petitioner has further argued that the aforesaid circular Annexure-R-A2 directing rounding up of the rate to a higher point in fact amounted to imposing a further tax upon the borrower, which was not permissible under the constitutional scheme prevalent in our country. We find substance in this argument also.

11. Article 265 of the Constitution provides that no tax shall be levied or collected except by the authority of law. What the law had permitted the banks was only to vary the terms of the agreement for liquidating the tax imposed upon the banks. Collection of excess amount under the circumstances of the case, would amount to an additional tax, which cannot be held to have been authorised by law. Article 265 not only prohibits the levy, but also prohibits the collection of a tax without the authority of law. Acquiescence by a party cannot

debar him from invoking the jurisdiction of this Court in seeking the relief of prohibiting the violator of law from making collection of the amount in the name of tax or for the purposes of liquidating its tax liability without the authority of law. The authority of law as envisaged by Article 265 refers to a valid law, which ex facie does not include the imposition or collection of the tax by an administrative order which is not referable to any statutory provision.

12. The word "tax" as used in Article 265 includes any impost -- general, special or local. It would include not only taxes, but also duties, cesses or fees. Any compulsory levy, under any name, if without the authority of law, has to be declared invalid, if it is proved that such levy was a compulsory exaction. In the instant case, the borrowers have been forced to pay additional amount by way of rounding up the amount of tax payable, which under the circumstances clearly established that the excess amount was being compulsorily exacted from them. The action of the respondents in collecting excess amount being without the authority of law and contrary to the provisions of Article 265 has to be declared invalid and ultra vires.

13. It has been stated at the Bar that by the time the writ petition was filed in the year 1994, the respondents-Banks had succeeded in collecting about Rs. 723.79 crores annually by way of resorting to round- ing up on the basis of the circular of respondent 30, which is declared by us to be unconstitutional, invalid and void. Petitioner has prayed for issuance of a writ of mandamus to direct all the scheduled banks to refund the excess interest collected from their borrowers as a result of rounding up to the next higher 0.25%. We are of the opinion that in view of the unspecified and large number of borrowers, such a direction, even if issued, is not possible to be implemented. We are, however, of the firm opinion that the excess amount collected by the banks being without the authority of law cannot be permitted to be retained by them.

14. Keeping in view the peculiar facts and circumstances of the case and in the light of our findings with respect to the impugned action of the respondents, we are of the firm belief that appropriate directions are required to be issued in the interests of the people in general and the State in particular. We are further of the opinion that the aforesaid amount should be recovered from the banks and escheated in favour of the Union of India.

15. Under the circumstances, the writ petition is allowed. Rule issued is made absolute. The action of the respondents-banks in rounding up interest rates to the next higher 0.25% is held illegal, arbitrary and untenable. A command is issued to all the banks to submit an account of the excess interest collected by them from the borrowers and deposit the same with the Reserve Bank of India to be debited in the account of the Union of India. The Reserve Bank of India-respondent 2 is directed to take immediate effective steps for implementation of our directions by calculating the excess interest collected by the banks and ensuring the same to be deposited in the funds of the Union of India.

16. The petitioner is held entitled to costs assessed at Rs. 10,000/- to be paid by respondent 30.