

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

TAX APPEAL NO. 207 of 2002

With

TAX APPEAL NO. 208 of 2002

FOR APPROVAL AND SIGNATURE:

HONOURABLE MS.JUSTICE HARSHA DEVANI

and

HONOURABLE MR.JUSTICE A.G.URAIZEE

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| 1 | Whether Reporters of Local Papers may be allowed to see the judgment ? | No |
| 2 | To be referred to the Reporter or not ? | No |
| 3 | Whether their Lordships wish to see the fair copy of the judgment ? | No |
| 4 | Whether this case involves a substantial question of law as to the interpretation of the Constitution of India or any order made thereunder ? | No |

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COMMISSIONER OF INCOME TAX....Appellant(s)

Versus

STATE BANK OF INDIA....Opponent(s)

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Appearance:

MR MANISH R BHATT, SENIOR ADVOCATE with MRS MAUNA M BHATT,
ADVOCATE for the Appellant(s) No. 1

MR RK PATEL, ADVOCATE with MR BD KARIA and MR DARSHAN R PATEL
ADVOCATES for the Opponent(s) No. 1

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CORAM: HONOURABLE MS.JUSTICE HARSHA DEVANI

and

HONOURABLE MR.JUSTICE A.G.URAIZEE

Date : 01/09/2015
COMMON ORAL JUDGMENT

(PER : HONOURABLE MS.JUSTICE HARSHA DEVANI)

1. These appeals under section 260A of the Income Tax Act, 1961 (hereinafter referred to as “the Act” are directed against the common order dated 12.2.2002 made by the Income Tax Appellate Tribunal, Rajkot Bench, Rajkot (hereinafter referred to as “the Tribunal”) in Interest Tax Appeal Nos.1 & 2/RJT/2000 for assessment years 1995-96 and 1996-97 respectively.

2. By an order dated 19.7.2002, this court had admitted the appeals on following substantial question of law:-

“Whether the Appellate Tribunal is right in law and on facts in holding that amount of Rs.4,26,05,914/- collected by the assessee bank from its borrowers as amount for interest tax, was not part of the interest on loans and advances within the meaning of section 2(7) read with section 2(5), 5 and 6 of the Interest Act, 1974 ?”

3. In proceedings under section 8 of the Interest Tax Act, 1974 (hereinafter referred to as “the Act”), the assessee claimed that the amount of Rs.4,26,05,914/- and Rs.5,54,96,239/- for assessment year 1995-96 and 1996-97 respectively, should be excluded from the chargeable interest. According to the assessee, these were not interest earned or received by the assessee from its borrowers and clients but they represented the amount of interest tax on chargeable interest recovered/collected by the assessee from its borrowers/clients and were, therefore, outside the purview of

chargeable tax as defined in the Act.

4. The Assessing Officer disallowed the claim mainly on the ground that the assessee had included the said interest in the return and no claim had been made by the assessee on this point by filing even a revised return as also on the ground that in the earlier years, the claim had been disallowed.

5. The Commissioner of Income Tax (Appeals) in the assessee's appeal, held that as per the clarifications issued by the Reserve Bank of India, the banks were advised to pass on the incidence of the interest tax, pro rata to their borrowers, irrespective of the category of borrowers or the types of advances. Therefore, whatever interest is charged from the borrowers will be part of the chargeable interest. The incidence of alleged interest tax passed on to the borrowers resulted into the additional charging of interest and not interest tax. Thus, the interest remained to be interest on loans and advances and, therefore, it formed part of the chargeable interest. According to the Commissioner (Appeals), neither the Act nor the guidelines of the RBI state that the nature of such enhanced interest would cease to be interest. It is well settled law that an entry by an accountant cannot change the nature of the income. Thus, a different treatment given by the bank to the enhanced interest charged in its books of account cannot change the nature of this accrual.

6. The Tribunal, after appreciating the material on record, has found that the facts of the present case are identical to the facts of the case of **Commissioner of Income Tax v. Bank of Madura Limited**, (1995) 215 ITR 928 and has directed that

the amounts of Rs.4,26,05,914/- and Rs.5,41,84,851/- be deducted from the amounts of chargeable interest returned by the assessee.

7. Assailing the impugned order, Mr. Manish Bhatt, Senior Advocate, learned counsel for the appellant invited the attention of the court to the provisions of the Act to point out that sub-section (7) of section 2 of the Act defines "interest", to mean any interest on loans and advances. It was submitted that what is collected by the assessee is interest, may be, it includes interest payable under the Interest Tax Act, nonetheless, it is in the nature of interest as contemplated under sub-section (7) of section 2 of the Act. Reference was made to the provisions of section 6 of the Act which provides for computation of chargeable interest and more particularly, to the explanation thereto which provides that in computing the chargeable interest of a previous year, no deduction, other than the deduction specified in that sub-section, shall be allowed from the total amount of interest accrued or arisen to the assessee. It was submitted that under section 6 of the Act deduction is only on interest which had become irrecoverable and that as per the mandate of section 6 one has to take the chargeable interest and deduct interest established to have become a bad debt, and that other than that no other deduction is permissible. It was argued that thus, the explanation gives a complete answer, namely that, except for what is expressly provided therein, there can be no further deduction. According to the learned counsel, the amount that the assessee collects from the borrowers is towards loan and advances and thus, it is the gross amount of interest that is collected and no amount is separately collected towards interest under the Interest Tax Act. It was, accordingly, urged

that the Tribunal was not justified in allowing deduction of the amounts collected by the assessee towards interest tax from its consumers.

8. Opposing the appeal, Mr. R. K. Patel, learned counsel for the respondent assessee submitted that the Tribunal has rightly followed the decision of the Madras High Court in the case of **Bank of Madura Limited** (supra). It was submitted that under the RBI guidelines, the bank has been permitted to recover the interest chargeable under the Interest Tax Act from the borrowers and that the tax collected for payment of interest is not synonymous with interest collected against the loan or advance made by the assessee. It was submitted that the assessee was merely an agent insofar as collection of the amount of interest tax is concerned, because of the overriding title of the Government. It was, accordingly, urged that the view adopted by the Tribunal being just, legal and proper and does not warrant interference by this court.

9. In rejoinder, Mr. M. R. Bhatt, learned counsel for the appellant pointed out that in the facts of the present case, the assessee had offered the total amount of tax as interest and hence the entire amount is required to be taken into consideration while computing the chargeable interest. As regards the contention of the learned counsel for the assessee that the assessee was merely an agent because of overriding title of the Government, reference was made to the decision of the Madras High Court in the case of *Bank of Madura Limited* (supra) to point out that the theory of diversion at source has not been accepted by that court. It was further submitted that in the case of *Bank of Madura Limited* (supra), the court has

not considered the Explanation to section 6 of the Act which provides for that no deduction other than that specified in that sub-section shall be allowed from the total amount of interest accruing or arising to the assessee while computing the chargeable interest. It was contended that since the gross interest is shown as income, the mere existence of the obligation to pay interest tax was not sufficient to constitute diversion of income, but was an application of income.

10. The facts are not in dispute. The assessee bank had made loans and advances to various parties at certain specified rates of interest. Under section 4 of the Act, every scheduled bank is required to pay interest at the prescribed rate on the chargeable interest of the previous year. The Reserve Bank of India issued guidelines whereby the banks were advised to pass on the incidence of interest tax, pro rata, to their borrowers, irrespective of the category of borrowers or the types of advances. Accordingly, the assessee bank collected such interest amount from the borrowers. However, while filing return of income, such amount collected from the borrowers towards interest payable under the Act was offered for tax. During the course of assessment proceedings, the assessee claimed that such amount did not form part of interest within the meaning of interest under the Act. However, such contention did not find favour with the Assessing Officer on the ground that no such claim had been made in the return nor was a revised return filed in respect of such claim. The Commissioner of Income Tax (Appeals) held that such amount collected by the bank, over and above, the interest chargeable by it also falls within the ambit of interest as contemplated under the Act. The Tribunal has followed the decision of the

Madras High Court in the case of **Commissioner of Income-tax v. Bank of Madura Limited** (supra) and directed that such amounts be deducted from the amount of chargeable interest returned by the assessee.

11. Before adverting to the rival contentions, reference may be made to the relevant provisions of the Act. Sub-section (5) of section 2 of the Act defines, "chargeable interest" to mean the total amount of interest referred to section 5, computed in the manner laid down in section 6. Sub-section (7) of section 2 defines "interest" to mean 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 (1B) of section 42 of the Reserve Bank of India Act, 1934 (2 of 1934);
 - (ii) discount on treasury bills;

12. Thus, interest as provided under sub-section (7) of section 2 of the Act, means interest on loans and advances made in India inclusive of the categories enumerated thereunder. A perusal of the categories mentioned thereunder clearly shows that interest tax collected from borrowers does not find place therein. As noticed earlier, the amount payable towards interest tax has been collected from the borrowers/customers in view of the guidelines issued by the RBI. In the opinion of this court, it is the interest on the loans

and advances made by the assessee inclusive of the categories mentioned in section 2(7) of the Act which would be the interest charged by the assessee on such loans and advances and the additional amount recovered from the customers towards payment of interest tax, which does not fall within the ambit of the expression “interest” as defined under the said sub-section, cannot be said to be interest on the loans and advances made by the assessee.

13. A perusal of the scheme of the Act reveals that section 4 is the charging section and as it stood at the relevant time it 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 (in the Act referred to as interest tax) in respect of its chargeable interest of the previous year at the rate of seven per cent of such chargeable interest. The proviso thereto says 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. Therefore, interest tax under the Interest Tax Act is payable in respect of any chargeable interest, which, as defined under sub-section (5) of section 2 means the total amount of interest referred to in section 5, computed in the manner laid down in section 6. Therefore, it may be apposite to refer to section 5 of the Act which makes provision for “Scope of chargeable interest” and says that subject to the provisions of the Act, the chargeable interest of any previous year shall be the total amount of interest (other than interest on loans and advances made to other credit institutions or to any cooperative society engaged in carrying on the business of

banking) accruing or arising to the credit institution in that previous year. Thus, chargeable interest is the total amount of interest accruing or arising to the credit institution in the previous year. According to the assessee, what accrues to the bank is the amount of interest chargeable on the loans or advances in terms of the agreement entered into between the parties at the time of giving such loan or advance, whereas, according to the revenue, the amount collected by the assessee from the borrowers towards the interest tax payable on the interest charged on the loan amount also forms part of the chargeable interest.

14. As noted hereinabove, the interest charged by the assessee on the loans and advances given to the customers is in terms of the rates specified in the respective agreement granting such loan or advance. The additional amount towards payment of interest tax in the light of the guidelines issued by the Reserve Bank of India is collected towards payment of interest tax. It has been contended on behalf of the respondent assessee that such amount of interest tax in view of the overriding title of the Government does not accrue to the assessee. According to the learned counsel for the revenue since the amount is firstly received by the assessee and thereafter paid over to the Government, the same amounts to application of income of the assessee. In this regard, it may be germane to refer to the decision of the Supreme Court in the case of **Commissioner of Income Tax v. Shitaldas Tirathdas**, (1961) 41 ITR 367, wherein it was held that the true test as to whether there is diversion of income by overriding title is whether the amount sought to be deducted, in truth, never reached the assessee as his income.

Obligations, no doubt, there are in every case, but it is the nature of the obligation which is the decisive fact. There is a difference between an amount which a person is obliged to apply out of his income and an amount which by the nature of the obligation cannot be said to be a part of the income of the assessee. Where by the obligation income is diverted before it reaches the assessee, it is deductible; but where the income is required to be applied to discharge an obligation after such income reaches the assessee, the same consequence, in law, does not follow. It is the first kind of payment which can truly be excused and not the second. The second payment is merely an obligation to pay another a portion of one's own income, which has been received and is since applied. The first is a case in which the income never reaches the assessee, who even if he were to collect it, does so, not as part of his income, but for and on behalf of the person to whom it is payable. Thus, where the assessee collects the amount, not as a part of his income but for and on behalf of the person to whom it is payable, the same would fall within the first category of cases. Examining the facts of the present case in the light of the principles enunciated in the above decision, even though the amount of interest tax is recovered by the assessee from its customers, the income in actual fact never reaches the assessee, who collects it, not as a part of its income but on behalf of the Government to whom it is payable. Therefore, payment of interest tax out of the amount collected from the customers towards payment of interest tax cannot be said to be application of the income of the assessee.

15. As regards applicability of the explanation to section 6 of the Act, as is sought to be contended by the learned counsel

for the revenue, section 6 of the Act provides that 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. The explanation thereto provides that in computing the chargeable interest of a previous year, no deduction, other than the deduction specified in the sub-section, shall be allowed from the total amount of interest accruing or arising to the assessee. Therefore, section 6 of the Act provides for computing chargeable interest accruing or arising to the assessee in the previous year. Thus, what is significant are the words, "interest accruing or arising to the assessee" because it is this interest which has to be taken into account while computing the chargeable interest. The question which, therefore, requires to be examined is as to what is the interest accruing or arising to the assessee. From the facts as emerging from the record, it is manifest that the interest which accrues or arises to the assessee bank is the interest chargeable on the loans and advances to the extent agreed between the parties. As discussed hereinabove, the additional amount charged from the assessee payable towards interest tax cannot in any manner be said to be interest which has accrued or arisen to the assessee. Therefore, such amount collected from the borrowers/customers towards payment of interest tax as expressly provided therefor by the RBI guidelines cannot be taken into consideration for the purpose of computing chargeable interest. Therefore, when the nature of the amount collected by the assessee does not fall within

the ambit of chargeable interest as contemplated in sub-section (5) of section 2 of the Act, the same cannot be taken into consideration while computing the chargeable interest. Consequently, the explanation to section 6 on which strong reliance has been placed by the learned counsel for the revenue would have no applicability to the facts of the present case.

16. Another aspect of the matter is that the RBI has issued guidelines permitting the financial institutions to recover the amount payable by way of interest tax from the customers. If the amount recovered from the customers towards interest tax is also considered as chargeable interest, further interest at the prescribed rate would have to be paid by the assessee on the total amount recovered by the assessee, namely, interest on loans and advances plus the amount collected from the customer towards interest tax, which would exceed the amount collected from the customer towards interest tax, thereby frustrating the very intention of the RBI guidelines, namely, to collect interest tax from the customer and not from the bank.

17. In the light of the above discussion, it cannot be said that the impugned order passed by the Tribunal suffers from any legal infirmity so as to warrant interference. The question is, accordingly, answered in the affirmative, that is, in favour of the assessee and against the revenue. The appeals stands disposed of accordingly.

(HARSHA DEVANI, J.)

(A.G.URAIZEE, J.)

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