

In the High Court of Judicature at Madras

Dated: 10.09.2014

Coram

The Honourable **Mr.JUSTICE R.SUDHAKAR**
and
The Honourable **Mr.JUSTICE G.M.AKBAR ALI**

Tax Case (Appeal) Nos.1110 & 1111 of 2004
& Tax CMP No.1 of 2014

The Commissioner of Incometax
Nungambakkam High Road,
Chennai - 600 034.

.... Appellant in both T.C.(A)s

vs.

M/s.Golden Investments Ltd.,
3 Second Line Beach
Chennai - 600 001
(since amalgamated with
M/s.United Breweries Ltd.)

.... Respondent in both T.C.(A)s

APPEALS under Section 260 A of the Income Tax Act against the order dated 19.7.2004 made in I.T.A.Nos.11 & 12(Mds)/98 on the file of the Income Tax Appellate Tribunal, Madras "C" Bench, Chennai.

For Appellant : Mr.T.Ravikumar
Standing counsel for Income Tax

COMMON JUDGMENT

(Delivered by R.SUDHAKAR,J.)

The above Tax Case (Appeals) filed by the Revenue as against the order of the Income Tax Appellate Tribunal for the assessment years 1993-94 and 1994-95 were admitted by this Court on the following substantial questions of law:

"1. Whether on the facts and in the circumstances of the case, the Income Tax Tribunal is right in law in holding that interest on debentures will not form part of chargeable interest under the Interest Tax Act?

2. Whether on the facts and in the circumstances of the case, the Income Tax Tribunal is right in law in holding that addition of notional interest are to be reckoned with for the purpose of calculating the chargeable interest under the Interest Tax Act?

3. Whether on the facts and in the circumstances of the case, the Income Tax Tribunal is right in law in following the judgment rendered in the case of Lakshmi Vilas Bank reported in 228 ITR 697 which was clearly a case dealing with pre-amended provisions of the Interest Tax Act which was applicable upto the assessment year 1991-92 and not subsequently?"

2. The assessee/respondent in both the appeals is engaged in the business of investment and share broking. They held shares in a company called M/s.Sona distillers, which got amalgamated with

M/s.Herbertson Limited. On such amalgamation, debentures were issued by the new company in respect of the interest earned on these debentures. The assessee was allotted convertible debentures in the above company in respect of shares held by the assessee in M/s.Sona Distilleries. Therefore, the assessee claimed exemption on the ground that the nature of investment is not chargeable under the Interest Tax Act. The Assessing Officer declined to accept such a claim and included the interest on debentures in the chargeable interest. The second issue relates to addition of notional interest. While arriving at the chargeable interest, the Assessing Officer added certain items of interest receivable from Devi Investments, Until Communication, Vinayaka Castings and UB Electronics to whom advances have been made and held that interest on advance for shares should also be included for the purpose of Interest Tax Act.

3. Aggrieved by the order of the Assessing Officer, appeals were filed before the Commissioner of Income Tax (Appeals), who dealt with the issue relating to interest tax on debentures in paragraph 2.2 of the order and held in favour assessee. Placing reliance on the decision of the High Court in the case of ***CIT v. Lakshmi Vilas Bank reported in (1997) 228 ITR 697***, the Commissioner of Income Tax (Appeals)

in paragraph No.2.2 held as follows:

"2.2 I have carefully considered the arguments of the learned counsel and the reasons adduced by the AO for effecting the addition. Debentures are essentially in the nature of bonds issued by companies and in the instant case, it is essentially investment. Because firstly these debentures came to be allotted to the appellant on amalgamation of the company where share the appellant held. Secondly, these debentures were fully converted into shares of M/s.Herbertson Limited on a later date. Such debentures clearly falls outside the purview of loans and advances mentioned in the interest tax act. I have also gone through the decision of the Hon'ble High Court of Madras in the case of CIT v. Lakshmi Vilas Bank reported at 138 CTR 230 wherein the Hon'ble High Court has clearly held that debentures are distinctly different from loans and advances. Respectfully following the decision of the Hon'ble High Court, the issue is decided in favour of the appellant. The addition made on this count is deleted."

4. Insofar as the addition of notional interest is concerned, the assessee contended that the notional interest was an item which was never received or was receivable by the assessee and that such notional interest falls outside the purview of chargeable interest under the Interest Tax Act. This contention was accepted by the

Commissioner of Income Tax (Appeals) and held as follows:

"I have carefully considered issue in the light of the arguments putforth by the learned counsel. The scheme of the interest tax Act and the intention behind the introducing of the Income tax Act makes it very clear that notional interest can never be considered as part of chargeable interest. Apart from the objects of introduction of the interest tax Act as reflected in the Finance Minister's speech referred to by the learned counsel the proviso to s.5 also throws considerable light on this issue. As per this proviso, even interest on bad and doubtful debts are not be considered as part of chargeable interest unless it is credited to the profit and loss account of the credit institution. Though the proviso is specifically with reference to Public Financial Institution etc. covered under s.43D of the I.T. Act, the principle laid down therein throws considerable light on whether notional interest can be a part of chargeable profit. In the instant case, the notional interest brought to tax under the Income Tax Act has never been considered as part of interest accrued or arisen to the appellant in the books of the appellant. I, therefore, hold that it is not right to add the notional interest for the purpose of arriving at the chargeable interest."

5. As against the orders of the Commissioner of Income Tax

(Appeals), the Revenue went on appeal before the Income Tax Appellate Tribunal. The Tribunal, by a brief order, placing reliance on the decision in the case of ***CIT v. Lakshmi Vilas Bank reported in (1997) 228 ITR 697***, held as follows:

"These are two appeals by the Department against the order of the CIT(A) dated 31.12.1997 under the Interest tax Act. The common issue in both these appeals is with regard to the interest on debentures and interest on assessed tax. The Madras High Court in CIT v. Lakshmi Vilas Bank Ltd. (1997) 228 ITR 697 had held that interest on debentures and interest received from income-tax are not interest within the meaning of Interest Tax Act and that the Interest Tax Act is not applicable to both these items. Respectfully following the said decision, we upheld the orders of the CIT(A). The appeals are accordingly dismissed."

6. Aggrieved by the order of the Income Tax Appellate Tribunal, the Revenue has filed the present Tax case (Appeals) raising the substantial questions of law referred supra.

7. Though the respondent was not served, since the appeal is of the year 2004 and the issue was considered at length by the Supreme Court, we are proceeded to dispose of the appeal. Heard learned

Standing Counsel appearing for the Revenue and perused the materials placed before this Court.

8. The first issue relates to the applicability of Interest Tax Act in respect of the interest earned on debentures. The Commissioner of Income Tax (Appeals) as well as the Tribunal relied upon the decision of this Court in the case of ***CIT v. Lakshmi Vilas Bank reported in (1997) 228 ITR 697***. At the time of hearing, we find that subsequent decision rendered by the Supreme Court reported in ***(2010) 321 ITR 371 (SC) (Commissioner of Income-Tax V. Sahara India Savings and Investment Corporation Ltd.)***, dealt with the issue, wherein the issue under consideration is as follows:

"Whether "interest" which the assessee earned on bonds and debentures was chargeable to tax in view of the definition of the term "interest" in section 2(7) of the Interest-tax Act, 1974 ?"

9. Thus the law formulated in the above decision of the Supreme Court is identical to the facts of the present case. The respondent/assessee in this case is a credit institution falling under Section 2(5B)(ii) of the Interest Tax Act, namely, investment company. Section 4(2) of the Interest Tax Act provides for interest tax under the

provisions of Interest Tax Act on credit institutions in respect of its chargeable interest of the previous year and the scope of chargeable interest is defined under Section 5 of the Interest Tax Act.

10. Section 2(7) of the Interest Tax Act, defines the word "interest" which is the key word for the purpose of determination reads as follows:

"2. In this Act, unless the context otherwise requires, ____

.....

(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 (1B) of section 42 of the Reserve Bank of India Act, 1934 (2 of 1934) ;

(ii) discount on treasury bills ;"

11. In the light of the above-said provisions, the Supreme Court considered the scope of interest tax on the interest receivable in respect of investment in debentures and held as follows:

"The Interest-tax Act, 1974, has been enacted with two-fold purposes, namely, as an anti-inflationary measure and for revenue collection. It is an Act which has been periodically passed for economic reasons, particularly when inflation takes over the economy. With this introduction, one needs to examine the provisions quoted hereinabove. Section 2(5) defines "chargeable interest" to mean total amount of interest referred to in section 5, computed in the manner laid down in section 6. In other words, the "scope of chargeable interest" is defined under section 5 whereas "com-putation of chargeable interest" is under section 6. Section 2(7) is the heart of the matter as far as the present case is concerned.

In accounting sense, there is a conceptual difference between loans and advances on one hand and investments on the other hand. Section 2(7) defines the word "interest" to mean interest on "loans and advances including commitment charges, discount on promissory notes and bills of exchange but not to include interest referred to under section 42(1B) of the Reserve Bank of India Act, 1934, as well as discount on treasury bills". Section 2(7), therefore, defines what is interest in the first part and that first part confines interest only to loans and advances, including commitment charges, discount on promissory notes and bills of exchange. Pausing here, it is clear that the interest-tax is meant to be levied only on interest

accru-ing on loans and advances but the Legislature, in its wisdom, has extended the meaning of the word "interest" to two other items, namely, commitment charges and discount on promissory notes and bills of exchange. In normal accounting sense, "loans and advances", as a concept, are different from commitment charges and discounts and, keeping in mind the difference between the three, the Legislature, in its wisdom, has specifically included in the definition under section 2(7) commitment charges as well as discounts. The fact remains that interest on loans and advances will not cover under section 2(7) interest on bonds and debentures bought by an assessee as and by way of "investment". Even the exclusionary part of section 2(7) excludes only discount on treasury bills as well as interest under section 42(1B) of the Reserve Bank of India Act, 1934.

Reading section 2(7) as a whole, it is clear that "interest on investments" is not taxable as interest under section 2(7) of the said 1974 Act."

12. A reading of the above decision, it is clear that the contention of the Department that interest earned on debentures is liable to interest does not hold good any more. A faint plea was made by the Revenue that post 1st October, 1991, consequent to amendment, interest under Section 2(7) of the Interest Tax Act would

include interest from debentures as well. We find that such an argument has also been considered by the Supreme Court against the Revenue and held as follows:

"It is the case of the Department, however, which needs to be addressed at this stage, that prior to October 1, 1991, the word "interest" in section 2(7) was defined so as to include any amount chargeable to income-tax under the head "Interest on securities". It is the case of the Department that by an amendment, with effect from October 1, 1991, the said item, namely, "amount chargeable to income-tax under the head "Interest on securities" stood deleted and, consequently, "interest on securities" would fall within the definition of the word "interest" under section 2(7). According to the Department, section 2(7) was not exhaustive and with the amendment with effect from. October 1, 1991, when "interest on securities" stood excluded, it (interest on securities) would automatically fall within the purview of the word "interest" under section 2(7) of the 1974 Act. We find no merit in this argument for two reasons. Firstly, as stated above, section 2(7), read as a whole, focuses only on interest accruing on loans and advances, commitment charges and discount on promissory notes and bills of exchange. It also specifically excludes interest under section 42(1B) of the Reserve Bank of India Act as well as discount on treasury bills. It was very easy for Parliament to expressly provide for "interest on

investments" to fall under section 2(7), but that has not been done. The reason is obvious. As stated above, one of the objects of enacting the 1974 Act is by way of an anti-inflationary measure. In an inflationary situation, the cost of borrowing for the Government also increases. One of the ways by which the cost of borrowing can be reduced is to see that companies like the respondent herein are made to invest in bonds and securities so that the Government is able to borrow monies at a cheaper rate as compared to its borrowings in the market. It is precisely for this reason that the Reserve Bank of India, which is a regulator and which is responsible for the credit management of the economy and which is empowered to issue directions from time to time not only with the object of regulating the credit but also to control businesses like non-banking financial companies and residuary non-banking companies by issuing directions under Chapter III-B of the Reserve Bank of India Act, issues directions and one of such directions which has been issued in the present case is called the "Residuary Non-Banking Companies (Reserve Bank) Directions, 1987". These Directions have been issued under sections 45J and 45K of the Reserve Bank of India Act, 1934."

13. Therefore, the decision in the case of ***CIT v. Lakshmi Vilas Bank reported in (1997) 228 ITR 697***, in effect, has been affirmed by the Supreme Court. Hence, following the above-said decision of the

Supreme Court, the substantial questions of law Nos.1 and 3 are answered against the Revenue and in favour of the assessee.

14. On the issue of addition of notional interest, we find that the Commissioner of Income Tax (Appeals) has given a clear finding that notional interest can never be considered as part of chargeable interest. He relied on the object of introduction of the Interest Tax Act and draws an analogy that interest on bad and doubtful debts ought not to be considered as part of chargeable interest unless it is credited to the profit and loss of the credit institution. He comes to the clear conclusion that the notional interest brought to tax under Interest Tax Act has never been considered as part of interest accrued or arisen in the books of account, namely, profit and loss account and therefore, the question of adding notional interest was declined. The Tribunal, however, has not gone into this issue at all.

15. We are at a loss whether such an issue was raised before the Tribunal by the Department, as we find that no grounds of appeal is attached to the typed set of papers annexed to the present appeals. If no issue has been raised before the Tribunal, on this score, we do not find any justification to answer the second question of law on

notional interest. Nevertheless, we find from the objects and reasons of the Interest Tax Act, 1974 and from the definition of "interest" under Section 2(7) of the Interest Tax Act, that the word "notional interest" does not figure anywhere. Therefore, the Commissioner of Income Tax (Appeals) was correct in deleting the addition of notional interest. Unless the statute provides for adding notional interest for the purpose of tax, it cannot be made applicable by implication. The Revenue has not shown any provision whereby, notional interest can be included for the purpose of tax. We, therefore, answer the second question of law against the Revenue and in favour of the assessee.

16. For the foregoing discussion we pass the following order:

(i) On the substantial questions of law admitted by this Court, we answer the same against the Revenue and in favour of the assessee;

(ii) consequently, the order of the Tribunal stands confirmed.

In the result, both the Tax Case (Appeals) are dismissed. No costs. Consequently, Tax C.M.P No.1 of 2014 is closed. We place on record our appreciation for the assistance rendered by

Mr.J.Balachander in the above matter.

Index : Yes/No
Internet:Yes/No
sl
To

(R.S.,J) (G.M.A.,J)
10.09.2014

1. The Income Tax Appellate Tribunal, Madras "C" Bench, Chennai.
2. The Commissioner of Income Tax (Appeals) - III, Chennai.
3. The Deputy Commissioner of Income Tax, Special Range III,
Chennai - 600 034.

R.SUDHAKAR,J.
AND
G.M.AKBAR ALI,J.

sl

T.C.(A) Nos.1110 & 1111 of 2004
& Tax CMP No.1 of 2014

10.09.2014