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IN THE HIGH COURT OF KARNATAKA AT BANGALORE

DATED THIS THE 11th DAY OF APRIL 2008

PRESENT:

THE HON'BLE MR. JUSTICE DEEPAK VERMA

AND

THE HON'BLE MR. JUSTICE ANAND BYRAREDDY

I.T.A. No. 124/2003 C/w

I.T.A. NO. 125/2003

BETWEEN:

1. The Commissioner of
Income-tax,
C. R. Building
Queens Road,
Bangalore
2. The Joint Commissioner
of Income-tax Assessment
Special Range-6
C. R. Building,
Queens Road
Bangalore

....APPELLANTS
COMMON

(By Shri. M.V. Seshachala, Advocate)

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AND:

M/s. Canfin Homes Limited
Shanti Kutir, No. 32
2nd Floor
Race Course Road
Bangalore – 560 001

... RESPONDENT
COMMON

(By Shri. G. Sarangan, Senior Advocate
along with H. Vani and R. Ramamurthy, Advocate)

These ITAs are filed under Section 260-A of I. T. Act, 1961 arising out of order dated 24.10.2002 passed in ITA No.12/Bang/2000 for the Assessment year 1997-98 in I.T.A.No. 124/2003 and 20/Bang/2000 for the Assessment year 1996-97 in I.T.A.No. 125/2003 and etc.

These appeals having been heard and reserved and coming on for pronouncement of Judgement this day, ANAND BYRAREDDY J., delivered the following:-

JUDGMENT

These appeals are heard and disposed of together, as they pertain to the same assessee – except that they are in respect of

two different but consecutive assessment years namely 1996-97 and 1997-98, respectively. The controversy and the questions of law involved are identical.

2. The assessee is a financial institution. The assessee had filed its return of Income under the provisions of the Interest Tax Act, 1974 (Hereinafter referred to as 'the Act' for brevity). The assessment in respect of the year 1996-97 was completed by order dated 19.3.1999. The chargeable interest declared was accepted.

3. However, the Commissioner of Income tax, in exercise of power under Section 19 of the Act, proceeded to hold, after hearing the assessee, by an order dated 17.8.2000 that a sum of Rs. 2,09,40,087/- additional interest collected by the assessee from its customers in respect of loans advanced, was also subject matter of levy under the Act. It was further held that as per Schedule 11 of the printed accounts of the assessee for the year ended 31.3.1996, a sum of Rs. 3,76,41,023/- was shown but the same was not examined by the Assessing Officer. And

accordingly he was directed to examine whether it would be chargeable as per the provisions of the Act after giving an opportunity to the assessee. The assessee had preferred an appeal to the Income Tax Appellate Tribunal against the above order. The Tribunal having allowed the appeal, the Revenue has preferred the appeal in I.T.A. No. 125/2003.

4. In respect of the assessment year 1997-98, the Assessment Officer held that amounts collected by the assessee from its debtors towards its liability to pay Interest tax forms part of the chargeable interest within the meaning of Section 2 (5) read with Section 5 of the Act. This was challenged by the assessee before the Commissioner - Income tax, unsuccessfully. On a further appeal by the assessee, before the Tribunal, the Tribunal had held in favour of the assessee. It is this which is under challenge in the connected appeal no. ITA 124/2003.

The questions of law that are raised in these appeals are:

(i) Whether the Tribunal is correct in law in holding that the order passed under Section 8(2) of the Act by the Assessing Officer is not prejudicial to the interest of the revenue and is not erroneous and therefore the Commissioner has no jurisdiction under Section 19 of the Act to bring the chargeable income to tax?

(ii) Whether the Tribunal is correct in law in holding that interest of Rs. 2,09,40,087/- collected from the debtors is not chargeable to tax under Section 26C of the Interest Tax Act?"

5. It is contended on behalf of the Revenue that the assessee had collected additional interest by invoking Section 26C of the Act. This additional amount can only be treated as chargeable interest. It is contended that Section 26C was incorporated into the Act only with effect from 1.10.1991 in order to facilitate credit institutions to vary the terms of agreements, in respect of term loan transactions entered into before 1.10.1991, so as to increase the rate of interest stipulated therein to the extent to which such institution is liable to pay interest under the interest-

tax under the Act. The said section cannot be pressed into service in respect of transactions entered into after 1.10.1991.

6. There is no provision under the Act which enables the assessee to collect any amount as interest tax and as the amounts collected are only by way of interest, the same is chargeable interest attracting the levy of interest-tax.

7. It is contended that the Tribunal could not have placed reliance on the decision in the case of Commissioner of Income-Tax Vs. Bank of Madura Limited, 215 ITR 928, as the said case pertained to the assessment years 1975-76 and 1976-77 when there was no provision similar to Section 26 C. Further the facts are also different – in that, the bank, in that case, was collecting interest tax from its borrowers and paying the same to the Government. The Court held that there was no prohibition to do so. It was held that the amount of tax collected would not fall within the definition of “interest” under Section 2(7) of the Act. It

is therefore, contended that there was clear evidence to show that the bank was collecting interest tax from its borrowers. On the other hand, in the present case, the assessee has collected interest at a higher rate and that no deduction could be given in respect of such amounts while computing the chargeable interest.

8. It is further urged that the assessee could not realise by way of tax, or any amounts akin thereto, which has not been authorised by the Parliament. And seeks to draw sustenance from the decision of the Supreme Court in the case of Indian Banks Association Vs. Devakala Consultancy 267 ITR 179, in this regard while relying on that portion of the decision, dealing with Section 26 C of the Act, at pages 188-189 thereto.

It is therefore, prayed that the appeals be allowed and the questions of law be answered in favour of the Revenue.

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9. Per contra, Shri. G. Sarangan, Senior Advocate, appearing for the respondents, contends that the decision of the Tribunal does not warrant interference and that appeals be dismissed. It is contended that a plain reading of Section 26C would indicate that was enacted only for a limited purpose of enabling institutions, such as the assessee, of passing on the burden of tax under the Act, to its borrowers. The Counsel would submit that if for instance a sum of Rs. 100 lent was charged with a rate of interest of 10% - the interest earned would come to Rs. 10/-. In terms of Section 26C the interest tax payable thereon is at 3% or 30 paise. Applying this to the amounts collected by the assessee, the accounts maintained by it, which have been scrutinized by the Revenue, would clearly disclose that out of Rs. 10.30p collected as interest on every Rs. 100, the sum of 30 paise has been passed on to the Revenue as Interest - tax. The additional interest so collected is in accordance with the enabling provision namely Section 26C and the assessee having acted in terms of the same - the Revenue seeking to treat the total sum of

Rs.10.30p as chargeable interest is clearly illegal and the Tribunal has therefore, rightly allowed the appeal of the assessee.

10. It is also contended that the decision in Bank of Madhura (supra) having been rendered with reference to a point of time when Section 26 C was not even in existence, the ratio of that decision would apply with greater force to the case of the assessee. The reliance sought to be placed by the Revenue on a sentence in isolation, in the decision of Indian Bank's Association is clearly untenable – the same is sought to be drawn out of context.

It is hence prayed that the appeals be dismissed.

11. On these contentions – we may firstly, note that the Interest Tax Act was enacted by Parliament with effect from 1.8.1974. The object of the Act was to impose tax on the total amount of interest received by Scheduled banks and credit institutions on loans and advances. The Act was withdrawn in the

year 1978, but re-introduced in the year 1980. It was again withdrawn in the year 1985. It was re-introduced yet again in the year 1991, by virtue of Finance (No.2) Act, 1991 (hereinafter referred to as 'the 1991 Act' for brevity) Section 26C was inserted with effect from 1.10.1991 under the 1991 Act. The same is reproduced here for ready reference:

"26C. 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 the interest-tax under this Act in relation to the amount of interest on the terms loan which is due to the credit institution."

12. From a plain reading a Section 26 C it is clear that the said provision vests a credit institution with power to vary an agreement, with a borrower in respect of a term loan sanctioned prior to 1991, to increase the rate of interest stipulated to the

extent of recouping its liability of interest tax. Thus passing on the burden of the tax on its borrowers.

13. The argument of the Revenue that Section 26C cannot be construed as a charging provision and that the said section having been introduced merely to mitigate the hardship of the institutions with respect to pre 1.10.1991 credit loan transactions so that such credit institutions can reimburse themselves on account of the tax liability ultimately from the borrowers.

14. In the light of a finding by the Tribunal that the assessee has, under agreements executed subsequent to the period 1.10.1991, incorporated a term imposing an obligation on its borrowers to pay to it such amounts as are payable by the assessee to the Central or State Governments on account of any tax levied on interest on the loan by such Government, is significant. The circumstance that the assessee having collected the liability of Interest-tax from its borrowers in terms of the contractual

obligation and not necessarily on the strength of Section 26C is material. And the further circumstance that the assessee had maintained a separate account in respect of the amounts, though collected as additional interest was in fact towards payment of interest-tax, does compel us to hold that the amounts so collected were not "interest" within the meaning of Section 2(7) of the Act and hence could not be treated as chargeable interest for purposes of the Act.

15. The Tribunal has rightly held that the decision in the case of Bank of Madhura, supra, would apply on all fours to the present case. The observation of the Supreme Court in the case of India Banks Association, supra, as to the scope of Section 26C is to the following effect:

"Section 26C of the Act:

Parliament by reason of the said Act imposed a tax on the banks and other financial institutions. By reason of the said Act, the appellants were not statutorily empowered to pass the burden thereof to the borrowers or realise the same on behalf of the Union of India. Concededly, in

terms of the agreement of the term loan, the appellants were not entitled to charge interest at a higher rate than the agreed one. Section 26C was, therefore, enacted so as to enable the bankers to realise the amount of tax which they were liable to recover on the chargeable interest. The appellants have proceeded on the basis that having regard to the definition of "chargeable interest" as contained in section 2(5) of the Act, the additional interest will have also to be calculated for the said purpose and the rate of tax must be calculated thereupon which, as noticed hereinbefore, resulted in adding of interest for the purpose of calculation of tax ad infinitum.

How Parliament thought of the matter is the question. The Union of India does not agree with the contentions of the appellants nor do we. The action on the part of the appellants suggests that they had put the cart before the horse. The action of taking recourse to section 26C would arise only when the chargeable interest is calculated whereupon only the incidence of tax under the said Act is required to be passed on to the borrowers by way of additional interest. The entire approach of the appellants was based on a wrong premise. The said Act, is a taxing statute. The Union of India under the said Act cannot direct or permit the bankers or the financial institutions of raise interest. The Act must, therefore, receive purposive construction so as to give effect to the purport and object it seeks to achieve. (see BBC Enterprise

Ltd. v. Hi-Tech Xtravision Ltd. [1990] 2 All ER 118 (CA) at 122-3; Mohan Kumar Singhanian v. Union of India, AIR 1992 SC 1; Murlidhar Meghraj Loya v. State of Maharashtra [1976] 3 SCC 684; Superintendent and Remembrancer of Legal Affairs to Government of West Bengal v. Abani Maity [1979] 4 SCC 85; Khet Singh v. Union of India [2002] 4 SCC 380; Indian Handicrafts Emporium v. Union of India [2003] JT 7 SC 446; Ashok Leyland Ltd. v. State of Tamil Nadu [2004] 3 SCC 1; [2004] 2 RC 249 and High Court of Gujarat v. Gujarat Kishan Mazdoor Panchayat [2003] JT 3 SC 50)

In the event, the contention of the appellants is accepted, the same would give rise to incongruous results. Such an interpretation, as is well-known, must be avoided, if avoidable. Furthermore, a statutory impost must be definite. Having regard to article 265 read with article 366(28) of the Constitution of India nothing is realisable as a tax or by way of recovery of tax or any action akin thereto which is not permitted by law.

It is neither in doubt nor in dispute that section 26C is an enabling provision. It has to be so construed, having regard to the term "lawful" used therein.

It merely prevails over an agreement under which any term loan has been sanctioned by the credit institution before October 1, 1991. It was "lawful" for the purpose of recovering the amount of tax which was payable by the

appellants 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 of the Act, thus, has a direct nexus with the statutory impost. The action on the part of the appellants in rounding off of the interest, thus, was wholly unjustified. Once it is held that increase in interest in a justifiable manner pertains to passing on the burden of tax, the contention that the same had been done by the bank in exercise of its contractual power must be rejected. A taxing statute must be construed reasonably. Nothing can be realised by way of tax or akin thereto which has not been authorised by Parliament."

And the Revenue seeking to rely on the last sentence of the said passage is not tenable. The assessee has not collected any amount which were not authorised or expressly prohibited.

16. We, therefore are of the firm opinion that the appellant has not made out any case on merits. The appeals are hence

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dismissed. The questions of law are answered in favour of the assessee and against the Revenue.

Sd/-
Judge

Sd/-
Judge

lb/nv