IN THE INCOME TAX APPELLATE TRIBUNAL
"B" BENCH : BANGALORE

BEFORE SHRI N. V. VASUDEVAN, VICE PRESIDENT AND
SHRI B. R. BASKARAN, ACCOUNTANT MEMBER

ITA No.3064/Bang/2018
Assessment Year : 2014-15

M/s. Krishna Bhagya Jala Nigam Limited, PWD Offices, Annexe, 3rd Floor, K. R. Circle, Bengaluru – 560 001. **PAN : AAACK 5850 B**		ACIT, Circle – 4(1)(1), Bengaluru.

Assessee by:	:	Shri. Raghavendra R. Chakravarthy, CA
Revenue by	:	Shri. Manjunath Karkihalli, CIT(DR)(ITAT), Bengaluru

Date of hearing	:	02.11.2021
Date of Pronouncement	:	10.11.2021

O R D E R

Per N. V. Vasudevan, Vice President:

This is an appeal by the assessee against the order dated 29.09.2018 of CIT(A)-4, Bangalore relating to AY 2014-15.

2. The only issue that arises for consideration in this appeal by the assessee is as to whether the revenue authorities were justified in disallowing a sum of Rs.7,48,39,937/- being guarantee commission paid to Government of Karnataka, on the ground that the assessee failed to deduct tax at source on the aforesaid payment made to Government of Karnataka by invoking the provisions of Sec.40(a)(iib) of the Income Tax Act, 1961 (Act).

3. The assessee is a wholly owned company formed by the Govt. of Karnataka for the purpose of implementation of the Upper Krishna Project in the state of Karnataka. The assessee availed certain loans from financial institutions. The Government of Karnataka stood as guarantor for the loans so availed by the assessee. Under section 5(1) of the Karnataka Ceiling on Government Guarantees Act, 1999 (Guarantor Act), the Government shall charge a minimum of one percent as guarantee commission which shall not be waived under any circumstance.

4. Assessee made payment of guarantee commission of Rs.7,48,39,937/- to Government of Karnataka. The assessee debited in its profit and loss account the sum paid as guarantee commission claiming the same as expenditure wholly incurred for the purpose of business under section 37 of the Income Tax Act.

5. The AO in the course of assessment proceedings for AY 2014-15 was of the view that the assessee ought to have deducted tax at source on the guarantee commission paid to Government of Karnataka as per the provisions of Sec.40(a)(iib) of the Act. The relevant provisions of Sec.40(a)(iib) of the Act which was inserted by the Finance Act, 2013 w.e.f. 1.4.2014 and which is part of Chapter IV of the Act that deals with computation of business income reads as follows:

> *"40. Notwithstanding anything to the contrary in sections 30 to 38, the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession".-*
>
> *(a)in the case of any assessee-*
>
> *(iib) any amount-*

(A) paid by way of royalty, licence fee, service fee, privilege fee, service charge or any other fee or charge, by whatever name called, which is levied exclusively on; or

(B) which is appropriated, directly or indirectly, from,

a State Government undertaking by the State Government.

Explanation.—For the purposes of this sub-clause, a State Government undertaking includes—
(i) a corporation established by or under any Act of the State Government;

(ii) a company in which more than fifty per cent of the paid-up equity share capital is held by the State Government;

(iii) a company in which more than fifty per cent of the paid-up equity share capital is held by the entity referred to in clause (i) or clause (ii) (whether singly or taken together);

(iv) a company or corporation in which the State Government has the right to appoint the majority of the directors or to control the management or policy decisions, directly or indirectly, including by virtue of its shareholding or management rights or shareholders agreements or voting agreements or in any other manner;

(v) an authority, a board or an institution or a body established or constituted by or under any Act of the State Government or owned or controlled by the State Government;"

6. Relevant portion of the 'Explanatory Note' appended to the amendment which introduced Section 40 (a) (iib), reads as follows;

"In order to protect the tax base of State Government undertakings vis-a-vis exclusively levy of fee, charge, etc or appropriation of amount by the State Government from its undertakings, section 40 of the Income Tax Act has been amended to provide that any amount paid by way of fee, charge, etc, which is levied exclusively on, or any amount appropriated, directly or indirectly, from a State Government undertaking, by the State Government, shall not be allowed as

deduction for the purposes of computation of income of such undertakings under the head – Profits and gains of business or profession.

The expression – State Government Undertaking for this purpose includes-

(i) a corporation established by or under any Act of the State Government;

(ii) a company in which more than fifty per cent of the paid-up equity share capital is held by the State Government;

(iii) a company in which more than fifty per cent of the paid-up equity share capital is held by the entity referred to in clause (i) or clause (ii) (whether singly or taken together);

(iv) a company or corporation in which the State Government has the right to appoint the majority of the directors or to control the management or policy decisions, directly or indirectly, including by virtue of its shareholding or management rights or shareholders agreements or voting agreements or in any other manner;

(v) an authority, a board or an institution or a body established or constituted by or under any Act of the State Government or owned or controlled by the State Government;"

7. The AO disallowed the guarantee commission under section 40(a)(iib) of the Act. The CIT(A) confirmed the order of the AO and hence this appeal by the assessee before the Tribunal.

8. We find that an identical issue whether section 40(a)(iib) of the Act is applicable to guarantee commission paid to Government of Karnataka by a wholly owned company of the Government of Karnataka was decided by this Tribunal in the case of Karnataka State Financial Corporation Vs. ACIT in ITA No.3190/Bang/2018 order dated 04.03.2021. The relevant observations of the Tribunal were as follows:

"7. The Plea of the Assessee on applying the provisions of Sec.40(a)(iib) of the Act and disallowing guarantee commission paid to the Government of Karnataka was:

(i) Guarantee Commission is not levy on a state Government undertaking by the State Government. It is purely a contractual payment. To qualify as a "levy" within the meaning of Sec.40(a)(iib) of the Act, the payment to the State Government by a State Government undertaking should be based on a power on the part of the State Government to impose a levy. It should be a compulsory exaction by the State Government from the State Government Undertaking. Guarantee Commission is paid in consideration for the State Government agreeing to suffer a detriment in the event of the Assessee not repaying the value of the bonds on its maturity.

(ii) For applying the provisions of Sec.40(a)(iib) of the Act there should be a levy of "royalty, licence fee, service fee, privilege fee, service charge or any other fee or charge, by whatever name called" , which is levied "exclusively on State Government undertaking by the State Government". Guarantee commission is not a levy imposed exclusively on the State Government undertaking by the State Government. The State Government issues Guarantees on behalf of the Government Departments, Public Sector Undertakings, Local Authorities, statutory Boards and Corporations and Co-operative Institutions. Since guarantee commission is charged on any guarantee given to any department of Government, public sector undertaking of state Government, the 'exclusivity' is not there. It was contended that 'exclusivity' will be lost if it is levied from more than one State Government undertaking.

(iii) Guarantee commission is a revenue expenditure and has to be allowed as deduction u/s.37 of the Act as held by the Hon'ble Supreme Court in the case of CIT Vs. Sivakami Mills Ltd. 227 ITR 465 (SC) and Hon'ble Andhra Pradesh High Court in the case of AP State Financial Corporation Vs. DCIT 372 ITR 315 (AP). Even after insertion of Sec.40(a)(iib) of the Act by the Fianance Act, 2013 w.e.f. 1.4.2014, to fall within the ambit of the said provision a payment should be in the nature of "royalty, licence fee, service fee, privilege fee, service charge or any other fee or charge, by whatever name called". Guarantee Commission is not "royalty, licence fee, service fee, privilege fee,

service charge". It will also not fall within the ambit of the residuary limb "or any other fee or charge, by whatever name called" used in Sec.40(a)(iib) of the Act. It was submitted that guarantee commission is neither a "fee" nor a "charge" which is "levied" within the meaning of item (A) of Sec.40(a)(iib) of the Act because as per the rule of interpretation 'noscitur a socii' which mandates that words in a statute are to be interpreted with reference to accompanying words. The principle of interpretation of statute "ejusdem generis" ('noscitur a sociis') to be adopted where general words follow specific words, is to understand the scope of the meaning of the general words will be restricted to the scope of the meaning of the specific words. To illustrate, in the phrase "apples, oranges, guavas, bananas and other such food-items", the phrase "other such food-items" can only include fruits. This is for the reason that the words "apples, oranges, guavas, bananas" create a genus, being fruits. The succeeding words "other such food-items" must be interpreted to fall only within that genus. The scope of "any other fee or charge" cannot extend beyond the genus created by the words "royalty, licence fee, service fee, privilege fee, service charge". Reliance was placed on the decision of the Hon'ble Rajasthan High Court, in CIT v. Rajasthan State Beverages Corporation Ltd. [2017] 393 ITR 421, wherein the meaning of the term 'privilege fees' used in Sec.40(a)(iib) of the Act was held to be fee paid for granting right to manufacture and vend the liquor/sale of country liquor/ Indian made foreign liquor and Beer and determination of privilege fee was within the jurisdiction of the State authorities and levy of such fee cannot be termed as application of income or dividend as well. It was held that the levy of privilege fee was like licence fee. The Hon'ble Court thus held that the nature of the sums contemplated by sub-clause (iib) are only those sums mandatorily levied by the government as a precondition for carrying out operations. It was submitted that by applying the principle of ejusdem generis, the meaning of the words "any other fee or charge, by whatever name called" must be restricted to compulsory or mandatory levies only, and not to contractual payments such as guarantee commission. This according to the Assessee is by virtue of the import of the words "royalty, licence fee, service fee, privilege fee, service charge" is to be so restricted. It was submitted that the mischief sought to be remedied by the insertion of sub-clause (iib) related only to such mandatory levies and not to contractual or voluntary

> *payments. It was argued that the plain meaning of the words "fee" and "charge" cannot not bring commission within their scope. Commission is distinguishable both in the manner in which it is computed and the nature of its legal existence. It is computed usually as a percentage of another amount. It comes into existence as consideration for a service of some sort and is dependent on another collateral financial transaction (here, the guarantee). These characteristics clearly distinguish commission from "fee" and "charge".*

8. The argument was rejected both by the AO and the CIT(A) by holding that the ambit of Sec.40(a)(iib) of the Act is very wide and it includes "any other fee or charge by whatever name called" levied on a state government undertaking by the State Government. Conseqently disallowance of expenses was made and the sum disallowed was added to the total income of the Assessee. The reasons given by the CIT(A) for confirming the action of the AO throw some light on the reasons for introduction of the provisions of Sec.40(a)(iib) of the Act. According to CIT(A), the legislative intent behind the introduction of section 40(a)(iib) was to offset the action of certain State Governments / and State government institutions / companies, in reducing the income-tax liability by diverting the same to the State-exchequer by way of notification. It cannot be disputed that the State-governments retain the statutory-authority over the state institutions yet, the 'income-tax Act' being the union law is applicable to all State-government as a whole and provides the overarching legal-framework for methodology of determination of final income. The legislative intent behind the insertion of the words 'Any charge or fee by whatever name called', clearly indicates that the profits of any taxable entity including a State-government corporation are subject to the norms of the Act, which are applicable across the board. The final observations of the CIT(A) was as follows:

- *In the present case, it is apparent that, the guarantee-commission paid of Rs. 13,80,10,000/- has been debited to the Assessee's P&L account, which has commensurately reduced the net-profit and the consequent income-tax liability! There appears to be no justification for charging commission by the State government from its own government-controlled corporation, in a strictly commercial sense, especially when such grants, accrue from the state government itself. In this view of the matter, the assessee's stand is not found to be acceptable.*

> *In background of the above detailed discussion and facts & circumstances of' the present case and binding nature of the. section 40(a)(iib), I do not see enough justification to interfere in the AO's action. The assessee's grounds of appeal in this regard are therefore disallowed."*

9. Aggrieved by the order of the CIT(A), the Assessee is in appeal before the Tribunal. The contentions of the parties are identical to the stand taken before the lower authorities. The learned counsel for the Assessee placed reliance on decision of Hon'ble Kerala High Court in the case of Kerala State Beverages (Manufacturing and Marketing) Corporation Ltd. Vs. ACIT (2020) 116 taxmann.com 555 (kerala). In the aforesaid decision, the issue for consideration was whether licence fee and shop rental (kist) paid by Assessee a State Government undertaking which was a company registered under the Companies Act, engaged in wholesale and retail trade of beaverages within the State of Kerala, has to deduct tax on sum paid to the State Government in the form of licence fee and shop rent (kist) in accordance with the provisions of Sec.40(a)(iib) of the Act. The argument on behalf of the Assessee in that case was similar to the argument of the Assessee in the present case viz., that the license fee and shop rent (kist) is not a levy exclusively on the Assessee and therefore does not fall within the ambit of Sec.40(a)(iib) of the Act. The Hon'ble Kerala High Court upheld the contention of the Assessee and held as follows:

> *"16. With respect to licence fee and shop rental (kist) levied for the retail business is concerned, both sides have advanced conflicting arguments. The situation is that, the business of retail in foreign liquor is restricted to the appellant and to the Consumer Federation, both being state government undertakings. The trade in toddy or other kind of spirits cannot in any manner be equated with the business of retail sale in foreign liquor, for the purpose of human consumption. Contention of the appellant seems to be that, since the said business is permitted also to one another state government undertaking, namely the Consumer Federation, the exclusivity of the levy for the purpose of Section 40 (a) (iib) will be lost. It was argued that, provision under Section 40 (a) (iib) makes it abundantly clear that the levy imposed or the amount appropriated from a state government undertaking shall not be allowed as deduction when the levy is imposed exclusively on such a state government undertakings. Since the levy is made from one more state government*

> *undertakings, the 'exclusivity' is not there.* ***In this regard, findings of the Tribunal is that, the wordings of Section 40 (a) (iib), "which is levied exclusively on" indicates that the fee or charge should be one exclusively levied from the state government undertakings, and it is not any fee or charge which is levied exclusively from the assessee by the state government. Therefore the question is whether the 'exclusivity' will be lost if it is levied from more than one State Government undertaking. Sub-clause (iib) of Clause (a) of Section 40 provides that, any amount paid by way of royalty, licence fee, service fee, privilege fee, service charge, or any other fee or charge "which is levied exclusively on" a state government undertaking by the State Government (emphasis supplied) alone will satisfy the ingredients for disallowance. The statute has not used the word; levied exclusively on the state government undertakings by the State Government. Instead, the word used is "exclusively on" "a state government undertaking". Therefore, inorder to bring the disallowance within the ambit and scope of Section 40 (a) (iib), it should be an exclusive levy on the assessee, which should be a state government undertaking. Since the licence fee and shop rental (kist) are also levied from the Consumer Federation with respect to the FL-1 licence granted, it becomes out of the purview of the term 'levied exclusively on a state government undertaking, contained in 40 (a) (iib). Therefore we are persuaded to hold that the disallowance made with respect to the licence fee and shop rental (kist) paid with respect to the FL1 licences granted to the appellant for retail trade in foreign liquor, cannot be sustained***."
>
> *(emphasis supplied)*

*10. We have considered the rival submissions. The facts of the case are not in dispute. The question is whether Guarantee commission paid by the Assessee to State Government can be said to fall within the ambit of Sec.40(a)(iib) of the Act. In this regard we find that the State of Karnataka has passed an Act called "**Karnataka Ceiling on Government Guarantees Act, 1999".** The preamble to the Act gives the reasons for enactment of the relevant law as*

> *"An Act to provide for ceiling on Government Guarantees and other matters connected therewith.*

> *Whereas it is expedient to provide for ceiling on the Government guarantees issued on behalf of the Government Departments, Public Sector Undertakings, Local Authorities, statutory Boards and Corporations and Co-operative Institutions and for promoting fiscal discipline of the State;*
>
> *BE it enacted by the Karnataka State Legislature in the fiftieth year of the Republic of India, as follows:-"*

11. The statement of objects and reasons for passing the said Act were as follows:

> ***"Statement of objects and Reasons - Act 11 of 1999. -** To give effect to the proposals made in the Budget Speech and also for implementing the recommendations of the Technical Committee of State Finance Secretaries to fix limit on Government Guarantees, it is considered necessary to bring out legislation to provide for limits on Government Guarantees issued on behalf of the Government Departments, Public Sector undertakings, Local Authorities, Statutory Boards and Corporations and Co-operative Institutions etc., for promoting fiscal discipline in the State.*
> *Hence the Bill. (Obtained from L.A. Bill No.13 of 1999"*

12. There was an Amendment to certain provisions of this Act by Act No.15 of 2002 and the reasons for such Amendment have been given in the statement of object and reason for the amendment as follows:

> ***"Act No. 15 of 2002. -** It is considered necessary to amend the Karnataka Ceiling on Government Guarantees Act, 1999 (Karnataka Act 11 of 1999) to provide that no guarantee commission shall be charged in respect of guarantees extended during the period from 1.4.2001 to 31.3.2002 for loans granted by the Karnataka State Co-operative Apex Bank Limited and Karnataka State Co-operative Agriculture and Rural Land Development Bank Limited for the purpose of Agriculture and in turn to require them to reduce one percent interest in their lending rate in respect of the agricultural loans disbursed by them during the said period.*
> *Hence the Bill. (L.A. Bill No. 4 of 2002)"*

13. It is thus abundantly clear that the Guarantee is not exclusively given by the State Government only to the Assessee which is a State Government undertaking but to various Government Departments, Public Sector undertakings, Local Authorities, Statutory Boards and Corporations and Co-operative Institutions etc., and also to for loans granted by the Karnataka State Co-operative Apex Bank Limited and Karnataka State Co-operative Agriculture and Rural Land Development Bank Limited for the purpose of Agriculture and in turn to require them to reduce one percent interest in their lending rate in respect of the agricultural loans disbursed by them. The decision of the Hon'ble Kerala High Court in the case of Kerala State Beverages Corporation Ltd. Vs. ACIT (supra) clearly supports the plea of the Assessee that there is no "exclusivity" in terms of charging of "Guarantee Commission". We quote the relevant observations of the Hon'ble Kerala High Court in this regard:

> *……. Therefore the question is whether the 'exclusivity' will be lost if it is levied from more than one State Government I.T. Appeal Nos. 135, 146 & 313/2019 -22- undertaking. Sub-clause (iib) of Clause (a) of Section 40 provides that, any amount paid by way of royalty, licence fee, service fee, privilege fee, service charge, or any other fee or charge "which is levied exclusively on" a state government undertaking by the State Government (emphasis supplied) alone will satisfy the ingredients for disallowance.* ***<u>The statute has not used the word; levied exclusively on the state government undertakings by the State Government. Instead, the word used is "exclusively on" "a state government undertaking". Therefore, in order to bring the disallowance within the ambit and scope of Section 40 (a) (iib), it should be an exclusive levy on the assessee, which should be a state government undertaking. Since the licence fee and shop rental (kist) are also levied from the Consumer Federation with respect to the FL-1 licence granted, it becomes out of the purview of the term 'levied exclusively on a state government undertaking, contained in 40 (a) (iib).</u>*** *Therefore we are persuaded to hold that the disallowance made with respect to the licence fee and shop rental (kist) paid with respect to the FL1 licences granted to the appellant for retail trade in foreign liquor, cannot be sustained."*

14. We therefore accept the argument of the Assessee that for applying the provisions of Sec.40(a)(iib) of the Act there should be a levy of "royalty, licence fee, service fee, privilege fee, service charge or any other fee or charge, by whatever name called" , which is levied exclusively on State Government undertaking by the State Government. Guarantee commission is not paid directly to the State Government and they are not levies imposed exclusively on the Assessee. The State Government issues Guarantees on behalf of the Government Departments, Public Sector Undertakings, Local Authorities, statutory Boards and Corporations and Co-operative Institutions. Consequently, we hold that the disallowance made u/s.4-(a)(iib) of the Act cannot be sustained.

15. We are also of the view that Guarantee Commission is not in the nature of a "levy" on a state Government undertaking by the State Government. It is purely a contractual payment. According to Black's Law Dictionary Fifth Edition, the word "**levy**" **means**:- "To assess; raise; execute; exact: tax; collect: gather; take". To qualify as a "levy" within the meaning of Sec.40(a)(iib) of the Act, the payment to the State Government by a State Government undertaking should be based on a power on the part of the State Government to impose a levy. It should be a compulsory exaction by the State Government from the State Government Undertaking. Guarantee Commission is paid in consideration for the State Government agreeing to suffer a detriment in the event of the Assessee not repaying the value of the bonds on its maturity. Guarantee Commission does not fall within the ambit of the mischief that was sought to be remedied by the legislature by inserting Sec.40(a)(iib) of the Act.

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9. Respectfully following the aforesaid decision, we hold that disallowance of guarantee commission under section 40(a)(iib) of the Act is not sustainable and the addition made in this regard is directed to be deleted.

10. In the result, the appeal of the assessee is allowed.

Pronounced in the open court on the date mentioned on the caption page.

Sd/-	Sd/-
(B. R. BASKARAN) **Accountant Member**	**(N. V. VASUDEVAN)** **Vice President**

Bangalore,
Dated: 10.11.2021.
/NS/*

Copy to:

1.	Appellants	2.	Respondent	3.	CIT
4.	CIT(A)	5.	DR, ITAT, Bangalore.	6.	Guard file

By order

Assistant Registrar,
ITAT, Bangalore.