

IN THE SUPREME COURT OF INDIA

**Civil Appeal No. 5283 OF 2004 With
Civil Appeals Nos.5284/2004, 5285/2004,
5286/2004 And Civil Appeal No.4294/2006**

COMMISSIONER OF INCOME TAX, KANPUR

Vs

**M/s SAHARA INDIA SAVINGS &
INVESTMENT CORPORATION LTD**

S H Kapadia And H L Dattu JJ.,

Dated: November 24, 2009

Revenue's appeal dismissed

JUDGEMENT

In this batch of Civil Appeals, the main issue which arises for determination is: 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.

Respondent Company is a company registered under the Indian Companies Act, 1956. One of the objects for which the company was incorporated is to buy, sell, invest or otherwise deal in securities, bonds or fixed deposits issued by any institution, body corporate, corporation, establishment constituted under any Central or State laws or any other securities in which the company may be required to invest under any law in force.

For deciding the afore-stated issue, one needs to examine the provisions of the Interest Tax Act, 1974 as under:

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

"(5) "chargeable interest" means the total amount of interest referred to in section 5, computed in the manner laid down in section 6;"

"(5A) "credit institution" means,-

(i) a banking company to which the Banking Regulation Act, 1949 (10 of 1949) applies (including any bank or banking institution referred to in section 51 of that Act);

(ii) a public financial institution as defined in section 4A of the Companies Act, 1956 (1 of 1956);

(iii) a State Financial Corporation established under section 3 or section 3A or an institution notified under section 46 of the State Financial Corporation Act, 1951 (63 of 1951); and

(iv) any other financial company."

(5B) "financial company" means a company, other than a company referred to in sub-clause (i), (ii) or (iii) of clause (5A), being-

(i) a hire-purchase finance company, that is to say, a company which carries on, as its principal business, hire-purchase transactions or the financing of such transactions;

(ii) an investment company, that is to say, a company which carries on, as its principal business, the acquisition of shares, stock, bonds, debentures, debenture stock, or securities issued by the Government or a local authority, or other marketable securities of a like nature;

(iii) a housing finance company, that is to say, a company which carries on, as its principal business, the business of the financing of acquisition or construction of houses including acquisition or development of land in connection therewith;

(iv) a loan company, that is to say, a company not being a company referred to in sub-clauses (i) to (iii) which carries on, as its principal business, the business of providing finance, whether by making loans or advances or otherwise;

(v) a mutual benefit finance company, that is to say, a company which carries on, as its principal business, the business of acceptance of deposits from its members and which is declared by the Central Government under section 620A of the Companies Act, 1956 (1 of 1956), to be a Nidhi or Mutual Benefit Society;

(va) a residuary non-banking company other than a financial company referred to in sub-clause (i), (ii), (iii), (iv) or (v), that is to say, a company which receives any deposit under any scheme or arrangement, by whatever name called, in one lump sum or in instalments by way of contributions or subscriptions or by sale of units or certificates or other instruments or in any other manner; or

(vi) a miscellaneous finance company, that is to say, a company which carries on exclusively, or almost exclusively, two or more classes of business referred to in the preceding sub-clauses;"

"(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;"

"Charge of tax

4.(1) Subject to the provisions of this 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 this 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:

Provided 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.

(2) Notwithstanding anything contained in sub-section (1) but subject to the other provisions of this Act, there shall be charged on every credit institution

for every assessment year commencing on and from the 1st day of April, 1992, interest-tax in respect of its chargeable interest of the previous year at the rate of three per cent of such chargeable interest:

Provided 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, 1997 shall be two per cent of such chargeable interest.

(3) Notwithstanding anything contained in sub-sections (1) and (2), no interest-tax shall be charged in respect of any chargeable interest accruing or arising after the 31st day of March, 2000."

"Scope of chargeable interest

5. Subject to the provisions of this Act, the chargeable interest of any previous year of a credit institution shall be the total amount of interest (other than interest on loans and advances made to other credit institutions or to any co-operative society engaged in carrying on the business of banking) accruing or arising to the credit institution in that previous year:

Provided that any interest in relation to categories of bad or doubtful debts referred to in section 43D of the Income-tax Act shall be deemed to accrue or arise to the credit institution in the previous year in which it is credited by the credit institution to its profit and loss account for that year or, as the case may be, in which it is actually received by the credit institution, whichever is earlier."

"Computation of chargeable interest.

6. (1) Subject to the provisions of sub-section (2), 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 :

Provided that such interest has been taken into account in computing the chargeable interest of the assessee of an earlier previous year and the amount has been written off as irrecoverable in the accounts of the assessee for the previous year during which it is established to have become a bad debt.

Explanation.- For the removal of doubts, it is hereby declared that in computing the chargeable interest of a previous year, no deduction, other than the deduction specified in this sub-section shall be allowed from the total amount of interest accruing or arising to the assessee.

(2) In computing the chargeable interest of a previous year, the amount of interest which accrues or arises to the assessee before the 1st day of August, 1974, or during the period commencing on the 1st day of March, 1978, and ending with the 30th day of June, 1980, or during the period commencing on the 1st day of April, 1985 and ending with the 30th day of September, 1991 shall not be taken into account"

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 herein-above. 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 "computation 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 accruing 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, is 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.

It is the case of the Department, however, which needs to be addressed at this stage, that prior to 1.10.1991, 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 w.e.f. 1.10.1991, 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 w.e.f. 1.10.1991 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 interests 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 the 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 IIIB of the Reserve Bank of India Act, issues

directions and one of such directions which has been issued in the present case is called as "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.

We quote herein-below relevant provisions of Chapter IIIB of the Reserve Bank of India Act, 1934 which refers to provisions relating to non-banking institutions receiving deposits and financial institutions. The relevant provisions are 45J, 45JA, 45K and 45Q which are as under:

"45J. Bank to regulate or prohibit issue of prospectus or advertisement soliciting deposits of money.-The Bank may, if it consider necessary in the public interest so to do, by general or special order,-

(a) regulate or prohibit the issue by any non-banking institution of any prospectus or advertisement soliciting deposits of money from the public, and

(b) specify the conditions subject to which any such prospectus or advertisement, if not prohibited, may be issued."

"45JA. Power of Bank to determine policy and issue directions.- (1) If the Bank is satisfied that, in the public interest or to regulate the financial system of the country to its advantage or to prevent the affairs of any non-banking financial company being conducted in manner detrimental to the interest of the depositors or in a manner prejudicial to the interest of the non-banking financial company, it is necessary or expedient so to do, it may determine the policy and give directions to all or any of the non-banking financial companies relating to income recognition, accounting standards, making of proper provision for bad and doubtful debts, capital adequacy based on risk weights for assets and credit conversion factors for off balance-sheet items and also relating to deployment of funds by a non-banking financial company or a class of non-banking financial companies or non-banking financial companies generally, as the case may be, and such non-banking financial companies shall be bound to follow the policy so determined and the directions so issued.

(2) Without prejudice to the generality of the powers vested under sub-section (1), the Bank may give directions to non-banking financial companies generally or to a class of non banking financial companies or to any non-banking financial company in particular as to-

(a) the purpose for which advances or other fund based or non-fund based accommodation may not be made; and

(b) the maximum amount of advances of other financial accommodation or investment in shares and other securities which, having regard to the paid-up capital, reserves and deposits of the non-banking financial company and other relevant considerations, may be made by that non-banking financial company to any person or a company or to a group of companies."

"45K. Power of Bank to collect information from non-banking institutions as to deposits and to give directions.- (1) The Bank may at any time direct that every non-banking institution shall furnish to the Bank, in such form, at such intervals and within such time, such statements information or particulars relating to or connected with deposits received by the non-banking institution, as may be specified by the Bank by general or special order.

(2) Without prejudice to the generality of the power vested in the Bank under sub-section (1), the statements, information or particulars to be furnished under sub-section (1), may relate to all or any of the following matters, namely, the amount of the deposits, the purposes and periods for which, and the rates of interest and other terms and conditions on which, they are received.

(3) The Bank may, if it considers necessary in the public interest so to do, give directions to non-banking institutions either generally or to any non-banking institution or group of non-banking institutions in particular, in respect of any matters relating to or connected with the receipt of deposits, including the rates of interest payable on such deposits, and the periods for which deposits may be received.

(4) If any non-banking institution fails to comply with any direction given by the Bank under sub-section (3), the Bank may prohibit the acceptance of deposits by that non-banking institution.

[(5) omitted by Act 51 of 1974]

(6) Every non-banking institution receiving deposits shall, if so required by the Bank and within such time as the Bank may specify, cause to be sent at the cost of the non-banking institution a copy of its annual balance-sheet and profit and loss account or other annual accounts to every person from whom the non-banking institution holds, as on the last day of the year to which the accounts relate, deposits higher than such sum as may be specified by the Bank."

~"45Q. Chapter IIIB to override other laws.-

The provisions of this Chapter shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law."

On analysing section 45J, as it applies to the relevant period, read with section 45K, it is clear that the Reserve Bank of India insists on non-banking institutions, which collect deposits, to provide for information in specified forms in relation to receipt of deposits including rates of interest payable by non-banking institutions on such deposits as well as the period for which the deposits may be received. Under section 45K(4), if any non-banking institution fails to comply with any of the directions given by the Bank, the Reserve Bank may even prohibit the acceptance of deposits by that non-banking institution.

These stringent provisions are made in the Reserve Bank of India Act for a reason that companies like respondent herein receives deposits from the public. To safeguard their interests, the Reserve Bank, as a Regulator, insists that every company, including respondent herein which is a non-banking institution, has to submit its returns in the prescribed form every year and it is in that light that the Reserve Bank of India has specifically issued what is called as Residuary Non-Banking Companies (Reserve Bank) Directions, 1987.

Under para 6 of the 1987 Directions, every residuary non-banking company has to deposit and keep deposited in fixed deposits with public sector banks or invest and keep invested in unencumbered approved securities or in other investments, a sum which shall not be less than the aggregate amounts of the liabilities to the depositors. We quote herein-below para 6 of the said Directions, 1987.

"6. Security for depositors.- On and from 15th May, 1987-

(a) Every residuary non-banking company shall deposit and keep deposited in fixed deposits with public sector banks or invest and keep invested in unencumbered approved securities (such securities being valued at their market value for the time being), or in other investments, which in the opinion of the company are safe, a sum which shall not, at the close of business on 31st December, 1987, and, thereafter, at the end of each half year, that is, 30th June and 31st December, be less than the aggregate

amounts of the liabilities to the depositors whether or not such amounts have become payable:

Provided that the sum so deposited or invested-

(a) not less than 10 per cent shall be in fixed deposits with any of the public sector banks;

(b) not less than 70 per cent shall be in approved securities; and

(c) not more than 20 per cent or ten times the net owned funds of the company, whichever amount is less, shall be in other investments. Provided that such investments shall be with the approval of the board of directors of the company.

Explanation.--"Net owned funds" shall mean the aggregate of the paid-up capital and free reserves as appearing in the latest audited balance-sheet of the company as reduced by the amount of accumulated balance of loss, deferred revenue expenditure and other intangible assets, if any, as disclosed in the said balance-sheet.

(2) Every residuary non-banking company shall entrust to one of the public sector banks designated in that behalf, deposits and securities referred to in clauses (a) and (b) of the proviso to sub-paragraph (1) to be held by such designated bank for the benefit of the depositors. Such securities and deposits shall not be withdrawn by the residuary non-banking company, or otherwise dealt with, except for repayment to the depositors.

(3) Every residuary non-banking company shall furnish to the Reserve Bank within thirty days from the close of business on 31st December, 1987, and thereafter, at the end of each half year, that is, as on 30th June and 31st December, a certificate from its auditors, being members of the Institute of Chartered Accountants, to the effect that the amounts deposited in fixed deposits and the investments made are not less than the aggregate amounts of liabilities to the depositors as on 30th June and 31st December of that year.

Explanation.- For the purpose of this paragraph- (a) "aggregate amounts of liabilities" shall mean total amount of deposits received together with interest, premium, bonus or toher advantage by whatever name called, accrued on the amount of deposits according to the terms of contract;

(b) "approved securities" means, the securities in which the trustee is authorised to invest trust money by any law for the time being in force in India and bonds or fixed deposits issued by any corporation established or constituted under any Central or State enactments;

(c) "public sector banks" means, the State Bank of India, the subsidiary banks and the corresponding new banks referred to in section 45(1) of the Reserve Bank of India Act, 1934 (2 of 1934);

(d) "unencumbered approved securities" shall include the approved securities lodged by the company with another institution for advance or any other credit arrangements to the extent to which such securities have not been drawn against or availed of."

The object behind issuance of para 6 is to protect the interests of the public who are investing in fixed deposits with the respondent herein. The object is to provide for sufficient capital so that there is no run on such institutions in future if they collapse. Under these Directions, the form of Return is prescribed. It has several parts. We are concerned with Part 5. On reading

this Part, it is clear that investments are required to be made by the respondent herein and they are required to be shown in the returns which the respondent herein has to file before the Reserve Bank of India periodically. In this case, there is no dispute as to filing of the returns by the said respondent before the Reserve Bank of India. The point to be noted is that the Directions make it very clear that when respondent herein buys bonds and debentures of approved nature, they constitute investment and they cannot be treated as loans and advances. Therefore, interest on such investment cannot be taxed under the Interest Tax Act, 1974.

Before concluding, one aspect needs to be mentioned.

One of the question raised by the Department before the Tribunal, though not specifically raised before us, was whether respondent herein was a "credit institution" as defined in section 2(5A) of the Interest Tax Act and, therefore, liable to be taxed under that Act in respect of the Assessment Year 1992-93? To answer the said question, we need to revisit section 2(5A) of the 1974 Act which defined "credit institution" to mean a banking company to which Banking Regulation Act, 1949 applies or a public financial institution as defined in section 4A of the Companies Act, 1956 or a State Financial Corporation established under section 3 or section 3A or an institution notified under section 46 of the State Financial Corporations Act, 1951 or any other financial company. The words "any other financial company" have also been defined under the 1974 Act vide section 2(5B) to mean a company being a hire-purchase finance company or an investment company or a housing finance company or a loan company, or a mutual benefit finance company or a miscellaneous non-banking company. On a bare reading of sections 2(5A) and 2(5B), it is clear that a residuary non-banking company did not figure in section 2(5A) and 2(5B) of 1974 Act. Secondly, para 2 of the 1987 Directions indicates as to what is a residuary non-banking company. We quote herein-below para 2:

"These directions shall apply to every residuary non-banking company, that is to say, a non-banking institution, being a company, which receives any deposit under any scheme or arrangement, by whatever name called, in one lump sum or in instalments by way of contributions or subscriptions or by sale of units or certificates or other instruments, or in any other manner and which, according to the definitions contained in the Non-Banking Financial Companies (Reserve Bank) Directions, 1977, or, as the case may be, the Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 1977, is not-

- (i) an equipment leasing company;
- (ii) a hire purchase finance company;
- (iii) a housing finance company;
- (iv) an insurance company;
- (v) an investment company;
- (vi) a loan company;
- (vii) a mutual benefit financial company; and
- (viii) miscellaneous non-banking company"

On reading para 2 of the 1987 Directions, it becomes clear that a residuary non-banking company is a company which receives deposits under any scheme or arrangement by way of contributions or subscriptions or by sale of units, certificates or other instruments or in any other manner and which, according to the definitions contained in the Non-Banking Financial Companies (Reserve Bank) Directions, 1977, or Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 1977, is not an equipment leasing company, a hire purchase finance company, a house finance company, an insurance company, an investment company, a loan company and a mutual benefit financial company. According to the Department, respondent herein fell under 'miscellaneous finance company' in terms of section 2(5B)(vi) of the

1974 Act. According to the Department, this Finance Act, 1992 operated prospectively and that too w.e.f. 1.4.1993.

According to the Department, during the Assessment Year 1992- 93, respondent herein stood covered under sub-clause (vi) of section 2(5B). We find no merit in this argument of the Department. Under section 2(5B)(vi), in order to constitute a miscellaneous finance company, it has to be a company which carries on exclusively two or more classes of business referred to in the preceding sub-clauses (i) to (v). In other words, if there is a company which is investment company and also finance company, it can fall under section 2(5B)(vi). Therefore, a residuary non-banking company cannot fall within sub-clause (vi) as contended by the Department as the said sub-clause specifically says that a miscellaneous financial company should carry two or more classes of business referred to in the preceding sub-clauses. Moreover, unlike residuary non-banking companies, none of the companies mentioned in sub-clauses (i) to (v) are empowered to accept deposits. In the circumstances, sub-clause (vi) did not cover residuary non-banking companies prior to 1.4.1993.

In the present case, it is not in dispute that after 1.4.1993, respondent herein has been filing its returns under the Interest Tax Act, 1974. For the afore-stated reasons, we find no merit in the Civil Appeals. The same are, accordingly, dismissed with no order as to costs.