

IN THE INCOME TAX APPELLATE TRIBUNAL
AHMEDABAD BENCH "A"

Before Shri MUKUL Kr. SHRAWAT, JUDICIAL MEMBER and
Shri A.K. GARODIA, ACCOUNTANT MEMBER

ITA No.2075/Ahd/2008 Assessment Year : 2005-06

The Income Tax Officer Ward-2(2) Ahmedabad	Vs.	Shri Parag Mahasukhlal Shah Prop of Shri Bearing, Kadia Kul, Relief Road Ahmedabad
PAN/GIR No. : ACUPS 1963 Q		
(APPELLANT)	..	(RESPONDENT)

And

CO No.120/Ahd/2008 – A.Y. 2005-06
(Arising out of ITA No.2075/Ahd/2008)

Sh. Parag Mahasukhlal Shah vs. The ITO
Ahmedabad Ward-2(2), Ahmedabad
(Cross Objector) .. (Respondent)

Revenue by :	Shri Roop Chand, Jt.CIT-DR
Assessee by:	Shri S.N. Divatia, A.R.

PER SHRI MUKUL Kr. SHRAWAT

The Revenue is in appeal

cross-objection, both have emanated from the order of Learned
CIT(Appeals)-VII Ahmedabad dated 26/03/2008 passed for Assessment
Year 2005-06.

(A) Revenue's appeal; ITA No.2075/Ahd/2008 – A.Y. 2005-06

2. The only ground of the Revenue is as follows:-

The Revenue is in appeal and the respondent-assessee has filed a cross-objection. (A) Revenue's appeal; ITA No.2075/Ahd/2008 – A.Y. 2005-06 2. The only ground of the Revenue is as follows:-
ITA No.2075/Ahd/2008 (By Revenue)
& CO No.120/Ahd/2008 (By Assessee)
Asst. Year – 2005-06
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1. The CIT(A) erred in deleting the addition made on account of interest payable on the amount of tax. 2.1. Facts in brief and the issue involved as emerged from the corresponding

*1. The CIT(A) erred in deleting the addition made on account of interest payment of Rs.7,83,666/- out of the total payment of Rs.12,47,746/- u/s.40(a) (ia) of the IT Act by holding that such **interest payment was additional purchase price.***

2.1. Facts in brief and the issue involved as emerged from the corresponding assessment order passed u/s.143(3) of the I.T.Act dated 28/09/2007 were that the assessee in his individual capacity is a proprietor of a concern dealing in trading of ball-bearings. It was noticed by the Assessing Officer that the assessee has claimed interest expenses of Rs.12,47,746/- as per Profit & Loss Account. Bifurcation of the interest account was submitted according to which out of the total interest claimed an amount of Rs.7,83,666/- was towards interest to FAG Bearing (India) Ltd. Admittedly, on the said amount of interest no tax was deducted at source . Explanation of the assessee was that since the **assessee was having dealership of FAG Bearing (India) Ltd. and reselling the ball-bearings, therefore as per the terms of payment he was allowed 2.5% cash discount on payments made within 15 days and 1.5% cash discount in case of payment made within 30 days.** It was also explained that as per the terms, the assessee was allowed interest-free credit period for 60 days. It was further informed **that in case of overdue payment the cost of purchase is paddled with a liability to pay a compensatory sum which was termed as interest.** Whenever there was default in making payment beyond the normal credit period, then the same was agreed to be compensated accordingly. It was, therefore, explained that the said amount was nothing but in the nature of **additional sale price** paid. As per the assessee since it was not in the nature of interest in strict terms, hence there was no liability to

deduct the tax at source. However, the Assessing Officer was not convinced and according to him as per section 2(28A) of the I.T.Act interest means, interest payable in any manner in respect of any money borrowed or debited. In his opinion, for such payment the provisions of section 194A of the I.T.Act were applicable. Finally, it was concluded that in terms of the provisions of section 40(a)(ia) of the I.T.Act, the expenditure of the said interest payment was to be disallowed. The matter was carried before the first appellate authority.

3. While deciding the issue in favour of the assessee, the Learned CIT(Appeals) has followed an order of the Jurisdictional High Court, namely, **Nirma Industries Ltd. vs. Dy. CIT reported at (2006) 283 ITR 402(Guj.)** and held that the interest received from the trade debtors for late payment of sales consideration is the amount derived from the sale proceeds. According to the judgment, purchaser pays higher sale price due to delay in payment. As per the argument the said payment is therefore out of the ambits of the TDS provisions. Accepting the defense, the Assessing Officer was directed to delete the addition.

4. From the side of the Revenue Learned Departmental Representative Mr.Roop Chand and from the side of the assessee Learned Authorised Representative Mr.S.N.Divatia have appeared who have respectively placed reliance on the orders of the Assessing Officer and the Learned CIT(Appeals).

5. We have heard both the sides at some length. Admitted factual position is that the assessee is having a dealership of FAG Bearing

(India) Ltd. and, therefore, in the business of sales of ball-bearings. This fact has also not been denied that there were certain terms and conditions agreed upon between the two parties in case of delay in payments. Whenever there was delay in payment or the payments got overdue, there was a condition to **compensate the delay**. Likewise, in case of prompt payment, the terms of payments have prescribed a **facility of cash discount**. Therefore, the fundamental and primarily argument from the side of the respondent-assessee was that the amount paid to compensate the delay in making the **payment was nothing but the added sales price of the said commodity**. Inter alia, it has also been argued that the impugned nature of payment was not within the **definition of interest as prescribed u/s.2(28A) of the I.T.Act**. With this factual back ground, the case laws relied upon is Nirma Industries Ltd.(supra), which now stood upheld and SLP of Revenue was dismissed as per the citation reported at (2008)166 Taxman 95 (SLP-28). In addition to this precedent, Learned Authorised Representative has also placed reliance on following decisions:-

Sl.No(s)	Decision in the case of ...	Reported in...
1.	CIT vs. Indo Matsushita Carbon Co.Ltd.	286 ITR 201(Mad.)
2.	British Bank	233 ITR 251(Bom)
3.	Jackson Engineering Co.Ltd.	231 CTR 348 (Del)
4.	CIT vs. Advance Detergents Ltd.	228 CTR 356(Del)
5.	Phatela Cotgin Industries P.Ltd. vs. CIT	303 ITR 411 (P&H)
6.	Tata Sponge Iron Ltd.	292 ITR 175(Ori)

6. We have carefully perused the decision of the Hon'ble Jurisdictional High Court,(Nirma Industires 283 ITR 402) wherein observation in respect of the issue involved is as under:-

*“33. However, the parties having made elaborate submissions, the matter may be examined from a slightly different angle. When the assessee enters into a contract for sale of its products it could either stipulate (a) that interest at the specified rate would be charged on the unpaid sale price and added to the outstanding till the point of time of realisation, or (b) that in case of delay the payment for sale of products worth Rs. 100 to carry the sale price of Rs. 102 for first month 's delay, Rs. 104 for second month 's delay, Rs. 106 for third month 's delay and so on. If the contention of Revenue is accepted, merely because the assessee has described the additional sale proceeds as interest in case of contract as per illustration (a) above, such payment would not be profits derived from industrial undertaking, but in case of illustration (b) above, if the payment is described as sale price it would be profits derived from the industrial undertaking. This can never be, because in sum and substance these are only two modes of realising sale consideration, the object being to realise sale proceeds at the earliest and without delay. **Purchaser pays higher sale price if it delays payment of sale proceeds.** In other words, this is a converse situation to offering of cash discount. Thus, in principle, in reality, the transaction remains the same and there is no distinction as to the source. It is incorrect to state that the source for interest is the outstanding sale proceeds. It is not the assessee 's business to lend funds and earn interest. The distinction drawn by Revenue is artificial in nature and is neither in consonance with law nor commercial practice.”*

7. In the light of the above precedent, we deem it proper to discuss the relevant provisions of IT Act.

7.1. **Section 2 (28A) of the I.T.Act has defined the term “interest”** as follows:

“Section 2(28A) : *“interest” means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized.”*

7.2. The true character of the term interest has been defined, but the definition appears to be wide , inter-alia, covers interest payable in any manner in respect of loans, debts, deposits, claims and other similar rights or obligation. This definition further includes service charges but those charges should be in respect of the money borrowed. By this definition, therefore, it is evident that if the charges are in respect of a debt or in respect of any credit facility then such charges are inclusive in the definition of “interest”. **Therefore, the interest is a payment of money in lieu of use of borrowings. It is payable by a debtor to the creditor.** But it is also worth to note that the said definition is not wide enough to include other payments. There ought to be distinction between the payments not connected with any debt, with a payment having connection with the borrowings. A payment having no nexus with a deposit, loan or borrowings is out of the ambits of the definition of interest as per section 2 (28A) of the I.T.Act. While pondering upon the issue, we have come across a decision of Respected National Consumer Disputes Redressal Commission, wherein in the case of Ghaziabad Development Authority vs. **Dr. N.K.Gupta reported at 258 ITR 337**, it was held as under:-

*“Held, affirming the order of the State Commission, that section 194A of the Income-tax Act, 1961, did not apply to the payment made by the petitioner Authority. The Authority was asked to pay interest on the amount refunded to the complainant because of its failure to construct the promised flat and to provide the necessary facilities. **The amounts deposited by the respondent with the petitioner Authority were not paid by way of deposit, nor had the petitioner Authority borrowed those amounts. Interest payment in this case was by way of damages.** Merely because the damages were described as by way of interest that did not convert them into interest under the Act. The word used in the order of the State Commission was not “interest” as defined in section 2(28A). Interest, in the order of the Commission, meant compensation or damages for delay in construction or handing over possession of the same causing consequential loss to the complainant by way of escalation in the price of the property and also on account of distress and disappointment faced by him. Interest, in the order, had been used merely as a convenient method to calculate the amount of compensation in order to standardize it. Otherwise, each case of an allottee would have to be dealt with differently. Nomenclature did not decide the issue. In view of the definition of “interest” in section 2(28A), the provisions of section 194A were not applicable and the petitioner Authority was wrong in deducting tax at source from the interest payable to the respondent (complainant).”*

7.3. This decision is very helpful to decide this appeal because it was held that if the nature of payment is to compensate an allottee, then the provisions of section 194A not to be applied as far as the question of deduction of TDS on interest is concerned. Though the said compensation was mentioned as “interest” but the Hon’ble Members have held that the word used “interest” did not fall within the definition as defined u/s.2(28A) of the I.T.Act.

8. **The provisions of section 194A** reads as follows:-

“Interest other than “Interest on securities”.

Section 194A:- (1) *Any persons. Not being an individual or a Hindu undivided family, who is responsible for paying to a resident any income by way of interest other than income [by way of interest on securities], shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rates in force.”*

8.1. If a person is responsible for **paying any income by way of interest** shall at the time of credit or at the time of payment is required to deduct income-tax. Vide an Explanation annexed to this section, it is clarified that where any income by way of interest is credited either under the “suspense account” or “interest payable account” or “by any other name”, then also such person is liable to deduct tax. On plain reading of this section, it is apparent that the term “interest” used in this section relates to and in connection of a debt or a loan or a deposit. The circumstances under which the assessee is required to deduct the tax has also been narrated. Therefore, a conclusion can be drawn that if a payment is compensatory in nature and not related to any deposit/debt/loan, then such a payment is out of the ambits of the provisions of section 194A of the I.T.Act. To buttress this legal proposition, we hereby placed reliance on the decision of Hon'ble Gujarat High Court in the case of **Nirma Industries Ltd. reported at (2006) 283 ITR 402(Guj.)**[supra], wherein the question was the admissibility of

deduction u/s.80HH and 80-I of the I.T.Act in respect of interest received from trade debtors. The observation was that when an assessee enters into a contract for sale of its product, it could either stipulate that interest at the specified rate would be charged on the unpaid sale price or it can be agreed upon that in case of delay the sale price shall escalate. As per the Hon'ble Court, the sum and substance of the discussion was that only two modes are plausible for realization of sale consideration. However, for a business man the object is to realize the sale proceeds at the earliest and without any delay. When the purchaser pays a higher sale price on account of delay in payments of the sale proceeds, then **the source being trade activity**, therefore, held as eligible profit of the Industrial Undertaking for the purpose of computation of deduction.

8.2 Almost on identical situation in the case of **Phatela Cotgin Industries P.Ltd. vs. CIT reported at [2008] 303 ITR 411 (P&H)**, the Hon'ble Court has stated that the interest which was received on delayed payment on account of sale to customers has to be termed as income derived from the Industrial Undertaking and such an income was held as distinct from interest income which is received from Fixed Deposit. The Courts have delivered these judgements by taking into consideration the immediate source of said receipt. If the immediate source is a loan, deposit, etc., then the payment is in the nature of “interest” but if the immediate source of receipt of payment is trade activity, then the nature of receipt is not “interest payment” but in the nature of payment of compensation.

9. In the case of **CIT vs. Indo Matsushita Carbon Co.Ltd. [286 ITR 201](Mad.)** the question was that whether **overdues from trade debtors is eligible** for relief u/s.80HHC/80-I of the I.T.Act. In that context the Hon'ble Court has commented that it is settled that the interest earned on the belated payment would be directly relatable to the business of the assessee. If the purchaser did not make the payment in time and agreed to pay the interest on the belated payments, the said interest would have direct nexus with the business activity. The true test would be whether such interest would have been available to the assessee otherwise also; and the answer to the question as per the Hon'ble Court was in negative. Hence, it was held that the interest being directly relatable only to the amounts receivable by the assessee during the course of its business on account of sale, the interest would have to be included as the profits and gains derived from the business of the assessee. An another decision cited therein was **CIT vs. The Madras Motors Ltd. reported at [2002]257 ITR 60 (Mad.)**.

10. In the case of **Phatela Cotgin Industries Pvt.Ltd. vs. CIT reported at 303 ITR 411(P&H)** the verdict was that the interest being received on delayed payment on account of sale to customers could clearly be termed to be an income derived from Industrial Undertaking. It was observed that such an interest is distinct from interest income which is being received from Fixed Deposit. Case laws referred were **CIT vs. Paras Oil Extraction Ltd. reported at [1998]230 ITR 266 (M.P.)** and **Pandian Chemicals Ltd. vs. CIT reported at [2003]262 ITR 278 (SC)**.

11. An another interesting feature involved to resolve this controversy is that the Revenue otherwise cannot allow the claim of payment u/s.36(1)(iii) of the Act because as per this section, the deduction is provided in respect of the amount of interest paid in respect of capital borrowed for the purpose of business. The only provision under the Act is section 37 under which this payment / expenditure is allowable being laid out wholly and exclusively for the purpose of the business. The nature of payment is such that it cannot be considered either u/s.56 of the Act, i.e. “Income from other sources” or u/s.57 of the Act prescribing deductions only in respect of “income from other sources”. Inter-alia, the conclusion is that since the nature of payment did not fall within the category of “income from other sources” as also cannot be allowed as payment of interest u/s.36(1)(iii), therefore, it’s true nature is nothing but added value of cost of purchase, hence no TDS was required to be deducted.

12. In the light of the overall discussion made hereinabove, we are of the view that the impugned payment had a direct link and immediate nexus with the Trade liability being connected with the delayed purchase payment, hence, did not fall within the category of “Interest” as defined in Sec.2(28A) of the I.T. Act for the purpose of deduction of Tax at Source as prescribed u/s.194A of the Act. Resultantly, this assessee cannot be held a defaulter of non-deduction of tax at source u/s.194A of the Act. The Learned CIT(Appeals) has rightly reversed the findings of the Assessing Officer. Ground raised of the Revenue is, therefore, **dismissed.**

(B) Assessee's Cross Objection No.120/Ahd/2008 – A.Y. 2005-06
(Arising out of 2075/Ahd/2008 – A.Y. 2005-06)

13. The following grounds have been raised by the assessee in the cross objection:-

1. *Assuming for the sake of argument that payment of Rs.7,83,666/- was interest payment, the amended provisions of section 40(a)(ia) of the Act would not be applicable and as such no disallowance is called for u/s.40(a)(ia) of the Act.*
2. *It is prayed that even assuming the payment of Rs.7,83,666/- as interest instead of additional purchase price, it is prayed that the disallowance may please be deleted.*

13.1) Cross Objection was not pressed by the Learned Authorised Representative, hence, the same is **dismissed** as such.

14. In the result, the appeal of the Revenue as well as cross objection filed by the assessee both are dismissed.

Order signed, dated and pronounced in the Court on 30th June, 2011.

Sd/-

(A.K. GARODIA)
ACCOUNTANT MEMBER

Sd/-

(MUKUL Kr. SHRAWAT)
JUDICIAL MEMBER

Ahmedabad; Dated 30/ 06 /2011

T.C. NAIR, Sr. PS

*ITA No.2075/Ahd/2008 (By Revenue)
& CO No.120/Ahd/2008 (By Assessee)
Asst.Year – 2005-06*

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Copy of the Order forwarded to :

1. The Assessee.
2. The Department.
3. The CIT Concerned
4. The Id. CIT(Appeals)-VII, Ahmedabad
5. The DR, Ahmedabad Bench
6. The Guard File.

BY ORDER,

सत्यापित प्रति //True Copy//

(Dy./Asstt.Registrar), ITAT, Ahmedabad