(1993) 68 TAXMAN 266

Calcutta High Court

Case No: IT Reference No. 33 of 1985

Commissioner of Income Tax		APPELLANT
	Vs	
Rajakatra (P.) Ltd.		RESPONDENT

Date of Decision: March 6, 1990

Acts Referred:

- Banking Regulation Act, 1949 - Section 51
- Income Tax Act, 1961 - Section 256(1), 40A(8), 40A(8)(ix)

Citation: (1993) 68 TAXMAN 266

Hon'ble Judges: Suhas Chandra Sen, J; Bhagabatiprasad Banerjee, J

Bench: Division Bench

Advocate: S.K. Mitra and R.C. Prasad, for the Appellant;J.P. Khaitan, for the Respondent

Judgement

Sen, J.
The Tribunal has referred the following question of law to this Court u/s 256(1) of the income tax Act, 1961 ("the Act"):

"Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that the loans from the directors of the assessee-company and/or the members of their family were not deposits within the meaning of Explanation (b) in section 40A(8) of the income tax Act, 1961 and in that view in deleting the interest disallowed by the income tax Officer under the provisions of section 40A(8) of the income tax Act?"

In this reference the assessment year involved is 1977-78 for which the corresponding relevant accounting year is the year ending on 31-12-1976.

2. The facts found by the Tribunal as contained in the statement of the case are as under:

In the course of assessment proceedings the ITO noticed that the assessee-company paid interest against deposits standing in its books of account in the names of its directors, members of their family and friends. As provided in section 40A(8) of the Act, the ITO disallowed 15 per cent of such interest in computing the total income of the assessee. Being aggrieved, the assessee filed appeal before the Commissioner (Appeals) against the orders of the ITO. Before him the assessee placed reliance on the decision of the Tribunal, Bombay Bench, in M.E. (P.) Ltd. v. ITO [IT Appeal No. 691 (Bom.) of 1979-80 dated 2-2-1980] and contended that the interest paid on current accounts maintained by the aforesaid persons was not liable to be disallowed u/s 40A(8). The Commissioner (Appeals) upheld the decision of the ITO with the following observations:

"I have carefully considered the submissions made on behalf of the appellant company. I do not agree with the submissions made. For the purpose of section 40A(8) deposit means any deposit of money and includes any money borrowed by a company. This definition is wide enough to include the monies borrowed from the directors or their friends and relations. Further, the facts in the present case are entirely different from the case decided by the Tribunal quoted above. In that case the main point which was considered by the Tribunal was that the interest was paid on current accounts maintained by the directors. In the present case the balance sheet clearly shows that the deposits from the directors and other persons are not current account but secured and unsecured loans bearing interest. Such being the case. I have no hesitation in holding that the interest has been paid on deposits within the meaning of section 40A(8). Such being the case the disallowance of interest by the income tax Officer applying provisions of section 40A(8) is in order. This ground is therefore rejected."

The assessee came up in appeal before the Tribunal against the order of the Commissioner (Appeals). The Tribunal, however, following the decision of the Tribunal, Bombay Bench "B", in IT Appeal No. 691 (Bom.) of 1979-80 directed that the disallowance made u/s 40A(8) should be deleted.

The Tribunal further held that the facts of the present case were similar to the facts in the case of M.E. (P.) Ltd. (supra) wherein the Tribunal had held that the provisions of section 40A(8) had no application. The Tribunal observed that:

"On a careful consideration of the facts and the submissions of the parties, we hold that the provisions of section 40A(8) could not be held to be attracted to the interest paid by the assessee on the current account balance of the managing director and other family members in this case. In the first place, as pointed out by the learned counsel for the assessee, the object of the enactment is to discourage companies other than a banking or a financial company from borrowing from the public by way of deposits at attractive rates of interest to the depositors as the borrowing from the commercial banks becomes costlier. Therefore, in considering provisions of this section we cannot overlook the mischief or loophole which is sought to be countered or plugged by this provision."

The case of the assessee was disposed of by the following observation:

"We see that the facts of the case before us are similar to those in the case of M.E. (P.) Ltd. (supra) inasmuch as on a perusal of the companies" accounts of different parties which are placed on record, with whom the assessee had been having transactions in current accounts we find that in most of the cases there were regular loan transactions in current accounts during the previous years relevant to the assessment years under appeal. We were also told that the concerned parties were either directors of the assessee-company and/or their family members and friends. Therefore, respectfully following the aforementioned order of the Tribunal with which we agree, we would hold that the lower authorities were not justified in disallowing a portion of the interest payment u/s 40A(8) of the Act. We, therefore, direct that the disallowance made u/s 40A(8) of the Act for all the years under appeal be deleted."

3. We have held in the case of Daga & Co. (P.) Ltd. v. CIT [IT Reference No. 148 of 1988 dated 14-2-1990] that the deposits made by the directors, share-holders and/or the other persons closely connected with the company will come within the mischief of section 40A(8) if the conditions laid down in the section were fulfilled. Section 40A(8) provides:

" Expenses or payments not deductible in certain circumstances. -(1) to (7)

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(8) Where the assessee, being a company (other than a banking company or a financial company), incurs any expenditure by way of interest in respect of any deposit received by it. fifteen per cent of such expenditure shall not be allowed as a deduction.

Explanation : In this sub-section-

(a) "banking company" means a company to which the Banking Regulation Act, 1949 (X of 1949), applies and includes any bank or banking institution referred to in section 51 of that Act;

(b) "deposit" means any deposit of money with, and includes any money borrowed by, a company, but does not include any amount received by the company-

(i) from the Central Government or any State Government or any local authority, or from any other source where the repayment of the amount is guaranteed by the Central Government or a State Government;

(ii) from the Government of a foreign State, or from a citizen of a foreign State, or from any institution, association or body (whether incorporated or not) established outside India;

(iii) as a loan from a banking company or from a co-operative society engaged in carrying on the business of banking (including a cooperative land mortgage bank or a co-operative land development bank);

(iv) as a loan from any institution or body specified in the list in the Tenth Schedule or such other institution or body as the Central Government may, having regard to the nature and objects of the institution or body, by notification in the Official Gazette, specify in this behalf;

(v) from any other company:

(vi) from an employee of the company by way of security deposit;

(vii) by way of security or as an advance from any purchasing agent, selling agent or other agent in the course of, or for the purpose of, the business of the company or as advance against orders for the supply of goods or for the rendering of any service;

(viii) by way of subscription to any share, stock, bond or debenture (such bond or debenture being secured by a change or a lien on the assets of the company) pending the allotment of the said share, stock, bond or debenture, or by way of advance payment of any moneys uncalled and unpaid upon any shares in the company, if such moneys are not repayable in accordance with the articles of association of the company;

(ix) as a loan from any person where the loan is secured by the creation of a mortgage, charge or pledge of any assets of the company (such loan being hereafter in this sub-clause referred to as the relevant loan) and the amount of the relevant loan, together with the amount of any other prior debt or loan secured by the creation of a mortgage, charge or pledge of such assets, is not more than seventy-five per cent of the price that such assets would ordinarily fetch on sale in the open market on the date of creation of the mortgage, charge or pledge for the relevant loan:"

The word "deposit" has been very widely defined. It includes any money borrowed by a company excepting the specified categories mentioned in sub-clauses (i) to (ix) in Explanation (b) to section 40A(8). If a person wants to deposit some money with a bank, he may do so by way of opening a current account or he may open a savings bank account or a short-term or long-term deposit account. It is entirety up to him to decide what sort of account he will open. Current account usually does not carry any interest. But for the deposit in the savings bank account the depositor is entitled to get interest. Explanation (b) to section 40A(8) has made the definition of "deposit" wide enough to take in not only the deposit of money with the company but also any money borrowed by the company. Therefore, the submission that these monies were not borrowed by the company will not improve the case of the assessee-company. The assessee will have to establish that the money was not even deposited with the company.

The amounts have been deposited with the company by the directors and the share-holders. This is not a case of a trading debt or a loan taken by the company. If that be so, then it is a clear case of deposit within the meaning of section 40A(8)(ix).

4. It has been argued on behalf of the revenue that the findings of the Commissioner (Appeals) and the ITO are also against the assessee. The moneys were not shown as loan in the balance sheet of the company and, hence, current account will not show the amounts as loan. At the end of the year there may be a debt but this cannot simply be treated as loan taken by the company.

5. Therefore, we are of the view that the Tribunal''s approach to the controversy was erroneous in law. We have already gone into the question and decided the controversy in the case of Daga & Co. (P.) Ltd. (supra). It has been contended by the advocate for the assessee that the real nature of the accounts of the directors has not been found out by the Tribunal. The Tribunal should reconsider the facts of this case. We remand the case back to the Tribunal and direct the Tribunal to decide the case in the light of the observations made hereinabove. If necessary, opportunity may be given to both the parties to adduce further evidence. We answer the question raised in the negative and in favour of the revenue. There will be no order as to costs.

Banerjee, J.

I agree.