

A

SHEW KISSEN BHATTAR

v.

THE COMMISSIONER OF INCOME TAX, CALCUTTA

March 5, 1973

B

[K. S. HEGDE, P. JAGANMOHAN KEDDY AND H. R. KHANNA, JJ.]

Indian Income Tax Act, 1922, s. 9(1)(iv)—Scope of—Consent decree in respect of property involved stipulating payment of compound interest by assessee—Assessee claiming deduction of compound interest—Interpretation of expressions “amount of any interest on such mortgage or charge” and “interest payable on such capital” in s. 9(1)(iv)—Held assessee entitled to deduct only simple interest payable.

C

The assessee, a trustee of the house property, claimed deduction of compound interest in terms of a consent decree passed in April 19, 1928, in a title suit in respect of the property. Under the terms of that decree, the property was held to belong to the first defendant who, however, was to make a payment of Rs. 8,61,000/- to the plaintiff therein. There was stipulation for the payment of compound interest on the unpaid amount @ 6½ with yearly rests. It was further provided therein that Rs. 4,25,000/- was to be paid on the execution of the terms of the settlement and therefore monthly instalment of Rs. 35,000/- for seventeen months and the balance in the 18th month. The terms of the compromise were not adhered to inasmuch as there were defaults in payment of interest. After making the payment on February 19, 1945, there still remained outstanding Rs. 2,70,535/-. The interest on this amount @ 6½ for a year worked out to Rs. 18,000/-. The assessee, however, calculated the total interest payable at Rs. 38,221/- for the assessment year 1956-57, relying on the clause in the agreement providing for payment of compound interest. The Income Tax Officer gave a deduction of Rs. 18,000/- only, on the basis of simple interest at the rate of Rs. 6½% per annum. The assessee's appeal against this order was dismissed by the Appellate Assistant Commissioner and later on by the Tribunal. On reference of the question and other similar questions in respect of the assessment years 1956-57 to 1958-59, the High Court held that only simple interest was allowable to the assessee.

D

E

F

On appeals by certificate to this Court, dismissing the appeals;

G

HELD: (1) What the law permits is the deduction of the “amount of any interest on such mortgage or charge.” Under the terms of the contract, when the interest payable is not paid, the same became a part of the principal and thereafter, interest has to be paid not only on the original principal but also on that part of the interest which had become a part of the principal. The interest which became part of the principal cannot be considered as the capital charge. What the assessee is entitled to deduct is the interest payable by him on the capital charge and not the additional interest which because of his failure to pay the interest on the due date had been considered as a part of the loan. The real capital charge is that which was originally due. The other portion is merely an interest on which the assessee has agreed to pay interest. Hence the interest paid on interest is not an interest paid on the capital charge. [570 B-D]

H

(2) 'Any interest' paid on capital borrowed or charged does not include compound interest. The compound interest is payable not on the capital charge but on that part of the interest on which he has agreed to pay interest. That is not the capital taken not of by s. 9(1)(iv). If the contention that "any interest" included compound interest is accepted as correct, then the door will be open for evasion of tax. Such an interpretation is impermissible.

CIVIL APPELLATE JURISDICTION : Civil Appeals Nos. 1500 to 1502 of 1970.

Appeals by certificates from the judgment and order dated January 28, 1969 and June 13, 1969 of the Calcutta High Court in Income-tax Ref. Nos. 202 of 1963 and 76 of 1968, respectively.

M. C. Chagla and *D. N. Mukherjee*, for the appellant.

J. Ramamurthi, *R. N. Sachthey* and *B. D. Sharma*, for the respondent.

The Judgment of the Court was delivered by

HEGDE, J.—These are appeals by certificate. A common question of law is involved in these appeals. These appeals relate to a common assessee but arise from three different assessments in respect of three different assessment years (1956-57 to 1958-59), the accounting years being the respective calendar years.

The question of law arising for decision is whether the assessee was entitled to claim deduction of compound interest under section 9(1)(iv) of the Indian Income-tax Act, 1922. The High Court answered that question in the negative and in favour of the Department. Aggrieved by that decision the assessee has come up in appeal to this Court.

To decide the question set out above, it will be sufficient if we refer to the facts relating to one of the assessment years *i.e.* 1956-57. The material facts are as follows :—

The assessee is a trustee of a house property at Chandmari Road, Howrah. In respect of that house there was a title suit filed by one Durga Prasad Chamria against Smt. Anardeyi and others claiming title over that property and for other reliefs. A consent decree was passed in that suit on April 19, 1928. Under the terms of that decree the aforementioned house property was held to belong to Smt. Anardeyi Sethani but she was to make a payment of Rs. 8,61,000/- to the plaintiff therein. There was stipulation for the payment of compound interest on the unpaid amount @ 6½% with yearly rests. It was further provided therein that Rs. 4,25,000/- was to be paid on the execution of the terms of settlement and thereafter monthly instalments of Rs. 35,000/- for seventeen months and the balance in the 18th month. The terms of the compromise were not adhered to inasmuch as there

- A** were defaults in payment of interest. After making the payment on February 19, 1945, there still remained outstanding Rs. 2,70,535/-. The interest on this amount @ 6½% for a year worked out to Rs. 18,000/-. The assessee, however, calculated the total interest payable at Rs. 38,221/- for the assessment year 1956-57, relying on the clause in the arrangement providing for
- B** payment of compound interest. The Income-tax Officer gave a deduction of Rs. 18,000/- only, on the basis of simple interest at the rate of 6½% per annum. The assessee's appeal against this order was dismissed by the Appellate Assistant Commissioner and later on by the Tribunal. Thereafter, at the instance of the assessee the following question of law was referred to the High
- C** Court, in respect of the assessment year 1956-57 :—

“Whether, on the facts and in the circumstances of the case, and on a true construction of the words ‘interest payable on such capital’ in section 9(1) (iv) of the Indian Income-tax Act, 1922, the amount of interest allowable was Rs. 18,000/- or Rs. 38,221/- ?”

- D** The questions referred to for the remaining assessment years are more or less similar. The High Court answered those questions, as mentioned earlier, in favour of the Department.

Herein we are called upon to consider the true scope of section 9(1) (iv) of the Indian Income-tax Act, 1922. The relevant portion of that section reads thus :—

- E**
- “(1) The tax shall be payable by an assessee under the head ‘Income from Property’ in respect of the *bona-fide* annual value of property consisting of any buildings or lands appurtenant thereto of which he is the owner, other than such portions of such property as he may
- F** occupy for the purposes of any business, profession or vocation carried on by him the profits of which are assessable to tax, subject to the following allowances, namely :—

- (i)
- (ii)
- G** (iii)
- (iv) where the property is subject to a mortgage or other capital charge, the amount of any interest on such mortgage or charge; where the property is subject to an annual charge not being a capital charge, the amount of such charge; where the
- H** property is subject to a ground rent the amount of such ground rent; and, where the property has been acquired, constructed, repaired, renewed or

reconstructed with borrowed capital, the amount
of any interest payable on such capital :

.....”

The question is whether the assessee is entitled to deduct the compound interest payable by him in accordance with the terms of the contract referred to earlier or whether he is only entitled to deduct simple interest at the rate of 6½% per annum. It must be borne in mind that what the law permits is the deduction of the ‘amount of any interest on such mortgage or charge’. The interest payable by the assessee on the capital charge was at the rate of 6½% per annum. But if he fails to pay that in accordance with the terms of the contract, he was liable to pay compound interest. In other words, if he fails to pay interest in accordance with the contract, he was liable to pay interest on interest. Or to put it differently, when the interest payable is not paid, the same became a part of the principal and thereafter, interest has to be paid not only on the original principal but also on that part of the interest which had become a part of the principal. It cannot be said that the interest which became a part of the principal can be considered as the capital charge. What the assessee is entitled to deduct is the interest payable by him on the capital charge and not the additional interest which because of his failure to pay the interest on the due date had been considered as a part of the loan. In fact, the real capital charge is that which was originally due. The other portion is merely an interest on which the assessee has agreed to pay interest. Hence we are unable to accept the connection of the assessee that the interest is an interest paid on the capital charge. Mr. Chagla, the learned counsel for the assessee, contended that the law permits his client to deduct any interest paid by him on the capital borrowed or charged and ‘any interest’ included compound interest also. This, to our minds, appears to be a fallacious argument. The compound interest is payable not on the capital charge but on that part of the interest on which he has agreed to pay interest. That is not the capital taken note of by section 9(1)(iv). If we accept Mr. Chagla’s contention as correct, then the door will be open for evasion of tax. All that the debtor need do is not to pay interest regularly but utilise that amount for other purpose and make the Revenue pay compound interest payable by him and thus derive advantage out of his own omission. Such an interpretation is impermissible.

We are clearly of the opinion that the interpretation placed by the High Court is the correct interpretation. In the result, these appeals fail and they are dismissed with costs; one hearing fee.