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***IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ ITA Nos. 227/2012 & 228/2012

NATIONAL COOPERATIVE DEVELOPMENT CORPORATION
..... Appellant

Through Mr. Rajat Navet, Advocate.

versus

ASSISTANT COMMISSIONER OF INCOME TAX ..... Respondent

Through Ms. Suruchi Aggarwal, Advocate.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE R.V.EASWAR

ORDER

% 10.04.2012

For the reasons stated in our decision dated 28th November, 2011, in the case of the appellant-assessee in ITA 512/2011 and other connected matters, the present appeals are dismissed.

SANJIV KHANNA, J.

R.V.EASWAR, J.

APRIL 10, 2012
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* IN THE HIGH COURT OF DELHI AT NEW DELHI

\+ **ITA NOs. 512/2011, 513/2011, 810/2011, 811/2011, 1139/2011, 1140/2011, & 1141/2011**

Reserved on : 16th November, 2011.
% **Date of Decision** : 28th November, 2011.

NATIONAL COOPERATIVE DEVELOPMENT CORPORATION .... Appellant
Through: Mr. Rajat Navet, Adv.

VERSUS

ASSISTANT COMMISSIONER OF INCOME TAX, CIRCLE 13(1) .....Respondent
Through : Ms. Suruchi Aggarwal, Adv.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE R.V. EASWAR

1. Whether Reporters of local papers may be allowed to see the judgment?
2. To be referred to the Reporter or not ? Yes.
3. Whether the judgment should be reported in the Digest? Yes.

R.V. EASWAR, J.:

These are seven appeals filed by the assessee under Sec.260A of the Income Tax Act, 1961 ("the Act" for short) against the orders of the

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Income Tax Appellate Tribunal ("Tribunal" for short) passed on different dates and for different assessment years as shown in the table below:

ITA No.	Assessment year	Date of Tribunal's order	No.of questions raised
512/2011	1999-2000	20-11-2009	6
513/2011	2004-05	20-11-2009	6
810/2011	2007-08	31-1-2011	7
811/2011	2001-02	11-3-2011	7
1139/2011	2000-01	29-4-2011	6
1140/2011	2002-03	21-4-2011	8
1141/2011	2003-04	13-4-2011	4

In respect of the assessment years 1999-00, 2004-05 and 2000-01 the assessee has raised the following questions which are common to all the three years:

(1) What is the true meaning and real effect in law of the provisions of Sec.36(1)(viii) of the Income Tax Act, 1961 as it existed for the relevant assessment year and what items of income can be considered as profits derived from business of providing long term finance which would in law be eligible for deduction u/s 36(1)(viii)?

(2) What are the principles to be applied for determining whether a particular item of income is derived from the business of providing long term finance for being eligible for deduction under Section 36(1)(viii) and whether the

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issue as to what is profits derived from such business of providing long term finance is to be decided on the basis of pragmatic business consideration rather than purely legalistic arguments?

(3) Whether in the facts and circumstances of the case, the Tribunal was correct in law in relying and applying the ratio of decisions which do not deal or pertain to the provisions contained in Sec.36(1)(viii) of the Income Tax act, 1961?

(4) Whether in the facts and circumstances of the case, the Tribunal was correct in law in holding that income earned by way of dividend from redeemable shares was not eligible for deduction under Section 36(1)(viii) of the Act?

(5) Whether in the facts and circumstances of the case, the Tribunal was correct in law in holding that interest earned on short term deposits made during the interregnum period between disbursement of funds was not profit derived from the business of long term finance and thus not eligible for deduction under Section 36(1)(viii) of the Act?

(6) Whether in the facts and circumstances of the case, the Tribunal was correct in law in holding that service charges earned by the Appellant for monitoring and implementation of SDF Loans was not eligible for deduction under Section 36(1)(viii) of the Act?

In respect of the assessment years 2007-08 and 2001-02 the assessee has, in addition to the above six questions, raised one more question which is as under:

> "Whether in the facts and circumstances of the case, the Tribunal was correct in law in holding that interest on advances/deposits and misc. receipts were not eligible for deduction under Section 36(1)(viii) of the Act?"

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In respect of the assessment year 2002-03, in addition to the above seven questions the assessee has raised the following question as question No.1:

> "Whether in the facts and circumstances of the case, the Tribunal was correct in law in upholding initiation of proceedings by the Assessing Officer under Section 148 of the Income Tax Act, 1961?"

In respect of the assessment year 2003-04, the assessee has raised the following four questions:

(1) Whether in the facts and circumstances of the case, the Tribunal was correct in law in upholding initiation of proceedings under Section 263 as well as the order passed by the CIT under Section 263 of the Act?

(2) What is the true meaning and real effect in law of the provisions of Sec.36(1)(viii) of the Income Tax Act, 1961 as it existed for the relevant assessment year and what items of income can be considered as profits derived from business of providing log term finance which would in law be eligible for deduction u/s 36(1)(viii)?

(3) What are the principles to be applied for determining whether a particular item of income is derived from the business of providing long term finance for being eligible for deduction under Section 36(1)(viii) and whether the issue as to what is profits derived from such business of providing long term finance is to be decided on the basis of pragmatic business consideration rather than purely legalistic arguments?

(4) Whether in the facts and circumstances of the case, the Tribunal was correct in law in relying and applying the ratio of decisions

which do not deal or pertain to the provisions contained in Sec.36(1)(viii) of the Income Tax Act, 1961?"

2. It is contended by the assessee that all the questions for all the years in appeal are substantial questions of law and therefore the appeals should be admitted. The revenue contests this position.

3. The assessee is a company set up under the National Cooperative Development Corporation Act, 1962 with the object of promoting the cooperative movement in the country.

4. We can take up ITA No.513/2011 as the lead case. In the return filed for this year, the assessee claimed that it was entitled to the deduction under Sec.36(1)(viii) of the Act in respect of the following items of income:

a) Dividend received in respect of redeemable preference shares in companies: Rs. 46,94,800

a) Interest on short-term deposits with banks: Rs.3,76,31,144

c) Service charges on SDF loans: Rs. 85,09,703

The deductions were claimed on the footing that the assessee was engaged in the business of providing long-term finance and the aforesaid items of income were derived from the said business as provided in Sec.36(1)(viii). The Assessing Officer did not accept the claim since according to him

these were not items of income "derived from" the business of providing long-term finance within the meaning of the Section.

5. On appeal, the CIT (A) endorsed the view taken by the Assessing Officer. On further appeal by the assessee to the Tribunal, the Tribunal held that though the aforesaid items of income can be said to be "attributable" to the business of providing long-term finance, that was not sufficient to attract the provisions of Section 36(1)(viii) and that the condition in the Section that the income should be "derived from" the business of providing long-term finance was not satisfied. In this view of the matter, it proceeded to examine every item of income in respect of which the deduction was claimed and recorded the following findings in paragraph 13 of its order:

a) That the dividend from redeemable preference shares represents return/dividend on investment and it cannot be said to represent profit from providing long-term finance and that there was nothing to show that the investment in the shares was made with a view to providing long-term finance;

b) That the interest from bank was received on deposits/FDs which were for short periods and even if they were for long periods they cannot be considered as profit derived from the provision of long-term finance to banks as essentially they are the assessee's investments;

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c) The service charges received by the assessee in respect of SDF loans did not represent any interest, that they were only service charges received by the assessee on loans given by the government but routed through the assessee and therefore the service charges cannot be said to be income or profit derived from the business of providing long-term finance.

6. We may first take up question No.4. In our view, it is a substantial question of law. The point to be considered is whether the dividend income received in respect of the investment in redeemable preference shares can be treated as profits derived from the business of providing long-term finance. "Long term finance" is defined in clause (h) of the Explanation to S.36(1)(viii) to mean "any loan or advance where the terms under which moneys are loaned or advanced provide for repayment along with interest thereof during a period of not less than five years". This takes us to the question whether a preference share can be held to be a loan or advance.

7. Section 85 of the Companies Act, 1956 provides for two kinds of share capital of a company: preference share capital and equity share capital. Section 80 makes detailed provisions for the issue by a company of redeemable preference shares. Clause (a) of the proviso to sub-section (1) thereof says that no such share shall be redeemed except out of profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of share capital made for the purpose of

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redemption. In **Globe United Engineering and Foundry Co. Ltd v Industrial Finance Corporation of India Ltd. (1974) 44 Comp. Cas. 347,** this Court observed: "The preference shares are really part of the company's share capital; they are not loans". In the light of the clear statement of this court, redeemable preference shares cannot be treated as loans.

8. In the case of ***Lalchand Surana & others v Hyderabad Vanaspathi Ltd. (1990) 68 Comp.Cas. 415***, the Andhra Pradesh High Court held that since redeemable preference shares can be redeemed by a company only out of its profits (which would otherwise be available for dividend) or out of proceeds of an issue made for the purpose of redemption, the holder thereof is not a creditor as such limitations imposed by the Proviso (a) to Section 80(1) of the Companies Act do not apply to an ordinary creditor. We must however add that the Andhra Pradesh High Court was concerned with the position of a redeemable preference shareholder after the failure of the company to redeem the share. In the case before us, we are concerned with the position of a redeemable preference share holder prior to the due date for redemption. If anything, such a case is on stronger footing and such shareholders can never be held to be a creditor of the company.

9. The issue had also arisen under the Interest Tax Act, 1974 before the Supreme Court in ***CIT, Kanpur vs Sahara India Savings and Investment Corporation Ltd. (2010) 321 ITR 371.*** The question before

the court was whether interest earned on bonds and debentures was chargeable to tax under the aforesaid Act having regard to the definition of the word "interest" in sec.2(7) of the said Act. Under this definition, interest means interest on loans and advances made in India; it included and excluded certain interest which is not relevant for our purpose. The question was whether bonds and debentures can be treated as loans and advances. It was observed by the Court that the interest on loans and advances will not cover interest on bonds and debentures bought by the assessee by way of "investment", within the meaning of Section 2(7). In this view it was held that such interest was not chargeable under the Interest Tax Act.

10. We may also refer to a judgment of the Gujarat High Court in ***Anarkali Sarabhai v. CIT Gujarat [1982] 138 ITR 437***. That case arose under the Income Tax Act and the question was whether the assessee was liable to pay capital gains tax on receipt of an amount equal to the face value of the preference shares when the company redeem them. The assessee received from the company an amount which exceeded the amount which he had paid for these shares. In deciding this question the Gujarat High Court had to examine the nature of redeemable preference shares issued by a company. The Court referred to Palmer's Company Law (page 356, paragraph 1, 22nd Edition) wherein it was observed that "from the financial point of view, redeemable preference shares are a hybrid form of shares and debentures, incorporating features of both, and

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being closer to the latter than other preference shares, but from the legal point of view they are shares and are treated as such". The Court further noted the view of the learned author in Pennington's Company Law, 4th Edition, page 195 that if redemption of the petitioner's shares would make a company insolvent, it may not be allowed to redeem those shares because repayment of preference capital would be a fraud upon the company's creditors. According to the Gujarat High Court this view of the author clearly indicated that the holder of preference shares is not in the same position as that of a creditor. The learned author had also expressed the view in the aforesaid treatise, as noticed by the Gujarat High Court, that if a company defaults in redeeming the preference shares by the date fixed for redemption, the holder thereof cannot compel it to do so by suing in debt for the return of his capital or by filing for a mandatory injunction. This view of the author, according to the Gujarat High Court also negatives the contention that once the company decides to redeem its preference shares, the holder thereof would be in the position of a creditor.

11. Having regard to the legal position adumbrated in the above judgments, we are of the view that investment in redeemable preference shares cannot be considered as a loan or advance made by the assessee to the company for interest. The basic characteristic of a loan is that the person advancing the loan has the right to sue on the debt, whereas the preference share holders cannot sue for the money due on the shares

undertaken to be redeemed and as of right claim a return of the money except in a winding up and that to after the redemption d. Similarly, a preference share holder stands on a different footing from person who has advanced monies to another. An "advance" has been defined in the Black's Law Dictionary as "to pay money or render other value before it is due; to furnish something before an equivalent is received or to furnish money for a specific purpose understood between the parties, the money or some equivalent to be returned" etc. Thus an advance is also quite different from preference shares in nature and character.

12. Having regard to the aforesaid discussion, we are of the view that there is no merit in the assessee's claim that the dividend received interest of the redeemable preference shares amounts to profits derived from providing long term finance within the meaning of Section 36(1)(viii) of the Act read with clause (h) of the Explanation to the Section. We, accordingly, answer the substantial question of law in the affirmative and in favour of the Revenue.

13. Question No.5 is directed against the finding of the Tribunal that interest earned on short-term deposits made during the interregnum period between disbursement of funds was not profit derived from the business of providing long-term finance. As held by the Tribunal, this is also an

investment of the funds of the assessee for making use of the idle funds remaining with it during the interregnum period. The interest cannot be considered as profit derived from the business of providing long-term finance within the meaning of the Section. No question of law arises out of the factual finding of the Tribunal, which is not challenged as perverse. The question cannot be admitted.

14. Question No.6 is directed against the finding of the Tribunal that the service charges on SDF loans do not qualify for the deduction because the loans are not provided by the assessee but are given by the Government through the assessee for which service charges are paid. This factual finding is not challenged by the assessee. The funds of the assessee are not involved. The Government's funds are routed through the assessee. The assessee cannot therefore be considered to be carrying on the business of providing long-term finance. It is in receipt of only service charges and not interest, obviously because its funds are not involved. It is also not the case that the assessee borrows monies from the Government for interest and advances loans for higher interest. In view of the factual position, no substantial question of law arises. We decline to admit the question.

15. We now turn to the first three questions which are general in nature. Having regard to the findings recorded by the Tribunal, which are not disputed, these questions are of academic nature. They do not raise any substantial questions of law. We decline to admit them.

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16. The questions raised by the assessee in ITA NO.512/2011 are identical. For the above reasons we decline to admit them.

17. Question Nos.1 to 5 raised in ITA No.1139/2011 are identical to the first five questions raised in the appeals in ITA Nos.513 & 512/2011. For the same reasons given above, we decline to admit them. Question No.6 is directed against the finding of the Tribunal that interest on advances/deposits or loans to employees amounting to Rs.9,95,152 does not qualify for the deduction because it does not represent profit derived from the business of providing long-term finance. In substance and qualitatively, there is no difference between the other items of income claimed to be eligible for deduction under Sec.36(1)(viii) and the interest received on advances/deposits or loans to employees. The Tribunal has therefore applied the same reasoning to this interest also. We do not see any substantial question of law arising from the finding of the Tribunal. Our reasoning in respect of the other questions applies to this question also. We therefore decline to admit the question No.6 in this appeal.

18. We now take up ITA Nos. 810 & 811/2011 relating to the assessment years 2007-08 and 2001-02 respectively. The first six questions raised by the assessee are identical with the six questions raised by it in ITA Nos. 512 & 513/2011. For the same reasons given by us in those appeals, we decline to admit these questions. Question No.7 in these two appeals (i.e., ITA Nos.810 & 811/2011) are identical to Question No.6 raised in ITA No.1139/2011, i.e., against the finding of the Tribunal

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that interest on advances or loans to employees does not qualify for the deduction. Following our reasoning given in the preceding paragraph, we decline to admit this question for this year. The question also refers to "miscellaneous receipts". The Tribunal has not dealt with this item of receipt separately and has applied the earlier orders passed by it for the assessment years 1999-2000 and 2004-05 to the miscellaneous receipts and held that they do not also qualify for the deduction. In our view, the same reasoning given by us in respect of the other items of income would apply to miscellaneous income also, the details of which have not been furnished to us. We accordingly decline to admit the questions raised by the assessee in ITA Nos. 810 & 811/2011.

19. We now take up ITA No.1140/2011 (asst. year: 2002-03) for consideration. In this year the assessee has raised eight questions, stated to be substantial questions of law. Question Nos. 2 to 8 are identical with Question Nos. 1 to 7 raised by the assessee in ITA Nos.810 & 811/2011 (asst. years: 2007-08 and 2001-02). For the reasons given by us in those appeals, we decline to admit question Nos. 2 to 8 for this year. In question No.1, the assessee has challenged the decision of the Tribunal holding that the reassessment proceedings were validly initiated under Sec.147/148 of the Act. The decision of the Tribunal is in paragraph 5 of its order. The findings on the basis of which the reassessment proceedings were held to be in order are:

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a) There is no discussion in the original assessment order about the various claims made by the assessee under Sec.36(1)(viii), except a bare reference to the assessee's letter dated 3-12-2004.

b) A perusal of the letter dated 3-12-2004 shows that it is just a general letter and did not contain any working for the purpose of the section.

c) The assessment was reopened within 4 years from the end of the assessment year and therefore the benefit of the proviso to Sec.147 is not available to the assessee.

d) The reassessment proceedings were not prompted by a change of opinion.

If that is so, it is obvious that the conclusion of the Tribunal that the reassessment proceedings were validly initiated cannot give rise to any question of law, much less a substantial question of law. We therefore decline to admit Question No.1 also for this year.

20. In ITA No.1141/2011, the assessee has raised four questions, stated to be substantial questions of law. Question Nos. 2 to 4 are identical with Question Nos.1 to 3 raised in ITA Nos. 512 & 513/2011 and for the reasons given by us in respect of those questions in those appeals, we decline to admit Question Nos.2 to 4 for this year. As regards the first question, it is directed against the finding of the Tribunal that the CIT had validly initiated revision proceedings under Sec.263 of the Act and set

aside the assessment order for de novo consideration and passing of fresh assessment order in respect of the various claims made by the assessee under Sec.36(1)(viii). These claims are the same as have been made in respect of the other years, viz., dividend on redeemable preference shares, interest on bank deposits/FDs, service charges on SDF loans, miscellaneous receipts, interest on loans/advances to employees etc. The Tribunal has taken the view in paragraph 5 of its order that the assessment order was erroneous in as much as it failed to take into account the amendment in Section 36(1)(viii) made by the Finance Act, 1985. It has also been held that the AO has failed to examine the claims made by the assessee for deduction under Sec.36(1)(viii). It is seen from the order of the CIT that in taking proceedings under Sec.263 he has referred to and relied upon the judgment of this Court in ***Gee Vee Enterprises (1975) 99 ITR 375*** wherein it was held that failure to make relevant enquiries would invite action under the Section on the ground that the assessment order is erroneous and prejudicial to the interest of the revenue. In our opinion, this judgment was rightly invoked by the CIT in the present case and his action was rightly upheld by the Tribunal. No substantial question of law arises in respect of this issue. We, therefore, decline to admit Question No.1 also for this year.

21. In the result, question No.4 raised in ITA No.513/2011 is answered in affirmative and against the assessee. The identical question raised in other appeals is also answered against the assessee. All other questions

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raised in all the appeals are not admitted as they are not substantial questions of law. The appeals are disposed of accordingly. No costs.

(R.V. EASWAR)
JUDGE

(SANJIV KHANNA)
JUDGE

NOVEMBER 28, 2011
vld/mm