

No TDS on interest payable for delay in payment of purchase price of goods

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- By S.K.Tyagi

Of late, in a number of cases, an issue has arisen whether tax is deductible at source, in respect of interest payable for delay in payment of purchase price of goods. There are occasions in the case of a manufacturing or trading concern where the concern is required to pay interest for delay in payment of the price of goods purchased. At times, the quantum of such interest is pretty high.

Most of the Income-Tax Advisors take a simplistic view of the matter and disallow the aforesaid interest in the computation of total income of the assessee, in view of the provisions of section 40(a)(ia) of the Income-Tax Act, 1961 (the Act). It will be appropriate to explain at this stage that as per section 40(a)(ia) of the Act, any interest shall not be deducted in computing the income chargeable under the head '*Profits and gains of business or profession*', if tax is deductible at source, but it has not been deducted at source in respect of such interest.

In my considered opinion, there is no TDS liability in respect of the aforesaid interest, nor is it practically feasible to do so for a businessman. In other words, no tax is deductible at source, in respect of interest payable by the purchaser for delay in payment of purchase price of goods.

In this connection, first of all, one has to examine the provisions of section 194A of the Act, which deal with TDS on interest other than interest on securities. In the present context, the provisions of section 194A(1) of the Act, will be required to be examined. The relevant part of section 194A(1) is reproduced as follows :

Interest other than "Interest on securities".

194A. (1) *Any person, 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 :*

From the aforesaid provisions of section 194A(1), it may be seen that any person, not being an individual or an HUF, who is responsible for paying to a resident any income, by way of interest, other than income by way of interest on securities, shall deduct income-tax thereon at the rates in force.

In view of the language used in the aforesaid provisions of section 194A(1) of the Act, it will be necessary to examine the meaning of the term '*Interest*', other than interest on securities. In this context, it may be stated that the term '*Interest*' has been defined under section 2(28A) of the Act. For the sake of ready reference, section 2(28A) is reproduced as follows :

Definitions.

2. In this Act, unless the context otherwise requires,—

(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 utilised ;

From the aforesaid provisions of section 2(28A) of the Act, it may be seen that '*Interest*' contemplated thereunder, is payable in respect of '*Moneys borrowed*' or '*Debt incurred*'. This view of also supported by two judgements of Delhi High Court, which are discussed as follows :

(i) *CIT Vs Sahib Chits (Delhi) (P) Ltd. [2010] 328 ITR 342 (Del)*

It was, *inter alia*, held in this case that a bare reading of section 2(28A) of the Act, would reveal that interest is payable in respect of '*Moneys borrowed*' or '*Debt incurred*'. It, of course, would include a deposit, claim or other similar right or application of any service fee or other charges in respect of the moneys borrowed or debt incurred.

(ii) *CIT Vs Cargill Global Trading P.Ltd [2011] 335 ITR 94 (Del)*

It was, *inter alia*, held in this case that it is clear from the definition in section 2(28A) of the Income-Tax Act, 1961, that before any amount paid is construed as interest, **it has to be established that the same is payable in respect of any money borrowed or debt incurred.**

It was also held in this case that the judgement of Gujarat High Court, in the case of *CIT Vs Vijay Ship Breaking Corporation [2003] 261ITR 113 (Guj)*, has been reversed by the Hon. Supreme Court, in the case of *Vijay Ship Breaking Corporation Vs CIT [2009] 314 ITR 309 (SC)*. Therefore, the aforesaid judgement of Gujarat High Court, will have to be disregarded in this context.

In the present scenario, no moneys are borrowed by the purchaser from the seller of goods. Therefore, the only issue which is to be examined now is whether there is a debt incurred in respect of the purchase price of the goods purchased by the assessee. In other words, it has to be examined whether any debt is incurred in the course of the transaction of purchase of goods. In addition, it has also to be examined whether the payment to be made by the purchaser of goods for delay in payment of purchase price thereof, will partake the nature of interest, as contemplated under section 2(28A) of the Act.

In order to answer the aforesaid queries, it would be necessary to examine the relevant provisions of the Sale of Goods Act, 1930. Besides, some other legal aspects and precedents which are relevant to the issue under consideration, will also be required to be examined. The same are discussed as follows :

1. Relevant provisions of the Sale of Goods Act, 1930.

In the present context, section 61 of the Sale of Goods Act, 1930, is relevant. The heading of the aforesaid section 61 is '*Interest by way of damages and special damages*'. For the sake of ready reference, the aforesaid section 61 is reproduced as follows :

61. Interest by way of damages and special damages.-

- (1) *Nothing in this Act shall affect the right of the seller or the buyer to recover interest or special damages in any case whereby law interest or special damages may be recoverable, or to recover the money paid where the consideration for the payment of it has failed.*
- (2) *In the absence of a contract to the contrary, the Court may award interest at such rate as it think fit one the amount of the price-*
 - (a) *to the seller in a suit by him for the amount of the price.- from the date of the tender of the goods or from the date on which the price was payable.*
 - (b) *to the buyer in a suit by him for the refund of the price in a case of a breach of the contract on the part of the seller- from the date on which the payment was made.*

From the aforesaid provisions of section 61(1), it may be seen that it saves the right which a party may have to recover interest (damages) or special damages, or to recover money paid on failure of payment of consideration. **It may also be seen that section 61 deals with payment of interest, by way of damages or special damages.** It would imply that the amount recoverable under the provisions of section 61 will partake the nature of damages or special damages. In other words, the aforesaid interest will partake the nature of damages or special damages.

Thus, as per the provisions of section 61(1), the interest recoverable either by the buyer or seller of goods, will partake the nature of damages or special damages, as the case may be.

Further, as per the provisions of section 61(2)(a), in the absence of a contract to the contrary, the Court may award interest to the seller at such rate as it thinks fit on the amount of the price in a suit filed by him, from the date of the tender of the goods or from the date on which the price was payable. The aforesaid provisions are equally applicable in respect of a refund of the price, in a case of breach of the contract on the part of the seller, as part of the aforesaid provisions of section 61(2)(b).

In this connection, a reference to the judgement of the Bombay High Court, in the case of *Islamic Investment Co Vs Union of India [2004] 265 ITR 254 (Bom)*, is also relevant. It was, *inter alia*, held in this case that interest component of decretal amount loses its original character and assumes the character of a *judgement-debt*. Once such an amount becomes part of a *judgement-debt*, the decree passed by the Court must be executed, subject to the deductions and adjustments permissible under the Code of Civil Procedure. It was further held that there was no provision under the Income-Tax Act, 1961, or under the Code of Civil Procedure to show that from the amount of interest payable under a decree, tax was deductible from the decretal amount, on the ground that it was an interest component on which tax was liable to be deducted at source. The aforesaid amount of interest cannot retain its character of interest.

In the light of the aforesaid discussion and conjoint reading of the provisions of the aforesaid sub-sections 61(1) and 61(2), it has to be concluded that -

- (i) The component of interest payable for delay in payment of purchase price of goods, will partake the nature of damages.
- (ii) Further, the aforesaid interest will be a part of judgement-debt, in case a suit is filed by the seller of goods, for the recovery of the sale consideration of the goods.
- (iii) No tax is deductible at source in respect of damages or judgement-debt.

Therefore, no tax is deductible at source, in respect of interest payable by the purchaser of goods for delay in payment of purchase consideration.

2. The impugned interest will partake the nature of sale / purchase consideration, as per a judgement of Bombay High Court.

In this context, a judgement of Bombay High Court, in the case of *CIT Vs Vidyut Corporation [2010] 324 ITR 221 (Bom)*, is also relevant. One of the issues before the Bombay High Court in

this case was whether interest received on account of delay in payment of the sale price of goods supplied by the assessee partakes the nature and character as sale consideration and accordingly, whether the assessee is eligible for deduction under section 80-IB of the Act, in respect of the aforesaid interest received by the assessee.

It was, *inter alia*, held in this case that in substance and in essence, what is received by the assessee from the purchaser is a component of interest towards delayed payment of the price of the goods sold, supplied and delivered by the assessee. There can be no dispute about the position that the price realized by the assessee from the sale of goods manufactured by the industrial undertaking, constitutes a component of the profits and gains derived from the eligible business. The purchaser, on account of delay in payment of the sale price also pays interest to the assessee. This forms a component of the sale price and is paid towards the lag which has occurred in the payment of the price of the goods sold by the assessee. On these facts, therefore, **the payment of interest on account of delay in payment of the sale price of the goods, supplied by the undertaking, partakes of the same nature and character, as the sale consideration.**

From the aforesaid observations of the Bombay High Court, it is quite clear that the interest payable on account of the delay in payment of the sale price of the goods, will partake the same nature and character, as the sale consideration. On the same analogy, the interest payable by the purchaser of goods on account of delay in payment of the purchase price thereof, will partake the same nature and character, as purchase consideration.

In the light of the aforesaid reasons, the said component of interest, being a part of sale consideration or purchase consideration of the goods, will not partake the nature and character of interest, as contemplated in section 194A, r.w.s.2(28A) of the Act. Therefore, no tax will be deductible at source, in respect of the aforesaid interest payable by the purchaser for delay in payment of purchase price of goods.

It may also be stated here that no tax at source is deductible under Chapter XVII-B of the Act, in respect of payment of purchase price of goods.

- 3. Similarly, in case of sale / purchase of a capital asset, the interest payable for delay in payment of sale / purchase consideration, will be part of sale / purchase consideration and hence, no TDS in respect of the same.**

In this regard, it has to be stated that if an assessee borrows funds for the purchase of a capital asset, then the interest payable on the borrowed fund will be added to the cost of acquisition of the capital asset. This view is supported by the following two legal precedents :

(i) *CIT Vs.K.Raja Gopala Rao [2001] 252 ITR 459 (Mad)*

It was held in this case that the cost of acquisition of a capital asset is not merely for the amount that has been paid to the vendor, but also the cost of borrowing for the purpose of paying the vendor and obtaining the sale deed.

(ii) *CIT Vs Sri Hariram Hotels P.Ltd [2010] 325 ITR 136 (Karn.)*

It was held in this case that for the purpose of computation of capital gains, the interest payable on the loans taken for the purchase of property, was to be included in the cost of acquisition of such property.

On analogical grounds, if the interest is payable for delay in the payment of sale consideration of the capital asset, then the same will also form part of cost of acquisition in the hands of the purchaser. Conversely, the aforesaid interest will form part of sale consideration, in respect of capital asset in the hands of the vendor.

Further, under Chapter XVII-B, there are only two sections relating to payment of compensation on acquisition of capital asset or immovable property, viz. sections 194L and 194LA. Section 194L deals with TDS in respect of payment of compensation on compulsory acquisition of a capital asset, whereas section 194LA deals with TDS in respect of payment of compensation on compulsory acquisition of certain immovable property.

In view of the aforesaid reasons, no tax will be deductible at source, in respect of the interest payable by the purchaser for delay in the payment of purchase consideration of a capital asset.

Further no discrimination can be made in respect of interest payable by the purchaser for delay in the payment of the purchase price of the goods or the purchase price of a capital asset. As already pointed out, no tax is deductible at source, in respect of the interest payable by the purchaser for delay in the payment of purchase consideration of a capital asset. Therefore, the same principles will equally apply to interest payable for delay in payment of purchase consideration of goods and accordingly, no tax will be deductible at source, in respect of interest payable by the purchaser for delay in the payment of purchase consideration of goods.

In the light of the aforesaid reasons, no tax will be deductible at source, in respect of interest payable by the purchaser for delay in the payment of purchase consideration of goods or capital assets.

4. A judgement of Mumbai Bench of the Tribunal also supports the aforesaid view.

In the present context, a judgement of Mumbai Bench of the Tribunal in the case of *Central Bank of India Vs JCIT [2006] 284 ITR (AT) 240 (Mum)*, is also relevant. In this case, the Hon. Tribunal was seized of an issue under the Interest Tax Act, 1974.

In this case, the assessee bank issued credit cards to its customers and paid the bills of vendors from whom credit card holders made purchases and in turn, the assessee raised bills on its customers. If the payment was not made by the due date, the service charges were debited to the accounts of the card holders and included in the billing for the next month. The Assessing Officer was of the view that the unpaid account due from the card holders was nothing but loan or advance made to the card holders and included the sum of Rs.3,11,14,255 in the chargeable interest. The Commissioner (Appeals) held that the service charges amounted to interest.

On appeal, it was held by the Tribunal that no money had been given by the assessee to the card holders. The assessee simply had provided credit facility to its card holders, which merely resulted in a relationship of creditor and debtor between the assessee and the card holders, as and when the credit facility was availed of by the card holders. **It only created a debt between the assessee and the card holders which was quite different from a debt created between the lender and the borrower of money. Further, no interest was payable if such payment was made before the due date. The interest was payable only when the debt was not paid by the due date.**

The case under consideration is almost similar, because interest is payable by the purchaser of the goods only in a case where payment is not made on or before the stipulated date, in respect of the sale consideration of the goods and no interest is payable if such payment is made before the due date.

Therefore, in the light of the aforesaid legal precedent and the facts prevailing in the case under consideration, the debt created, if at all, in respect of the goods sold will be quite different from a debt created between the lender and borrower of money. Hence, the sale consideration of the goods will not partake the nature of '*Debt incurred*', as contemplated under section 2(28A) of the Act and accordingly, the interest payable on account of delay in the payment of purchase price of the goods will not fall within the purview of the definition of '*Interest*', as contemplated under section 2(28A) of the Act and therefore, the provisions of section 194A will not be applicable in respect thereof.

5. Conclusion

In the light of the discussion in the preceding paras, it may be safely concluded that –

- (i) As per section 61 of the Sale of Goods Act, 1930, the interest payable for the delay in payment of sale consideration of the goods sold, will be of the nature of **damages** or **special damages** and obviously, the same will not fall within the purview of the definition of ‘Interest’, as contemplated under section 2(28A) of the Act and accordingly, no tax will be deductible at source under Chapter XVII-B of the Act, in respect thereof.

Besides, in case of suit filed by the seller of goods, the interest payable for the delay in the payment of sale consideration of the goods, will form part of the *judgement-debt*, which is not liable to TDS, under the provisions of Chapter XVII-B of the Act.

- (ii) The interest payable by the purchaser for delay in payment of purchase consideration of goods, will partake the nature and character of purchase consideration in the hands of the purchaser. This view is supported by the judgement of Bombay High Court, in the case of *CIT Vs Vidyut Corporation [2010] 324 ITR 221 (Bom)*.

Further, no tax is deductible at source under Chapter XVII-B of the Act, in respect of payment by way of purchase consideration of goods on the part of the purchaser thereof. Therefore, no tax will be deductible at source, in respect of the aforesaid interest payable by the purchaser for delay in payment of purchase consideration of goods.

- (iii) Besides, interest payable for delay in payment of purchase consideration, in respect of a capital asset, being part of purchase consideration of the capital asset, will not be liable to TDS, under the provisions of Chapter XVII-B of the Act.

On the same analogy, the interest payable by the purchaser for delay in payment of purchase consideration of goods will also not be liable to TDS, under the provisions of Chapter XVII-B of the Act.

- (iv) Further, in the light of the judgement of the Mumbai Bench of the Tribunal, in the case of *Central Bank of India Vs JCIT [2006] 284 ITR (AT) 240 (Mum)*, the debt incurred, if at all, in respect of sale / purchase consideration of goods, will be quite different from a debt created between the lender and borrower of money.

Therefore, the debt incurred in respect of the sale / purchase consideration of goods, will not fall within the purview of the expression, '*Debt incurred*', as contemplated under section 2(28A) of the Act.

In view of the aforesaid reasons, no tax will be deductible at source under section 194A of the Act, in respect of interest payable by the purchaser for delay in payment of purchase price of goods.

In view of the aforesaid reasons, no tax will be deductible at source under section 194A of the Act, in respect of interest payable by the purchaser for delay in payment of purchase consideration of goods.

S. K. TYAGI	☎ Office	: (020) 2613 3012	Flat No.2, (First Floor)
M.Sc., LL.B., Advocate		: (020) 40024949	Gurudatta Avenue
Ex-Indian Revenue Service	Residence	: (020) 40044332	Popular Heights Road
Income-Tax Advisor	E-mail	: sktyagidt@airtelmail.in	Koregaon Park
			PUNE - 411 001
