

Word 'interest' includes liquidated damages payable by borrower in case of default: HC

Summary – The High Court of Madras in a recent case of Infrastructure Development Finance Co. Ltd., (the Assessee) held that where under loan agreement an additional obligation was cast upon borrower to pay penal interest in event of committing default in repayment of loan, penal interest, as liquidated damages, would be 'interest' under section 2(28A) eligible to exemption under section 10(23C)

Facts

- The assessee claimed exemption under section 10(23G) in respect of liquidated damages payable by a borrower to the assessee in the event of a borrower committing default in repayment of the loan advanced by the assessee.
- The Assessing Officer, held that the liquidated damages were a sort of compensation in nature received from defaulters and hence could not be treated like income arising from the activities of the assessee in respect of infrastructure financing.
- On appeal, the Commissioner (Appeals) affirmed the decision of the Assessing Officer. It was held by the Commissioner (Appeals) that liquidated damages could not be equated to interest receipt or service fee etc.
- On second appeal, the Tribunal held that the right to receive liquidated damages accrue on account of default in the payment of bills as stipulated in the agreement and did not arise on account of any delay in the payment of loan. Therefore the Tribunal affirmed the decision of the Assessing Officer and the Commissioner (Appeals) that the liquidated damages could not be construed as interest to attract the provisions of section 10(23G).
- On appeal:

Held

- It must be remembered that under the terms of a loan agreement, a borrower is imposed with a primary obligation to repay the principal together with interest. An additional obligation is cast upon a borrower to pay interest on interest or penal interest, in the event of borrower committing a default upto a particular level. In some finance agreements, the finance companies also stipulate the payment of liquidated damages, if the default exceeds a particular tolerance limit. Irrespective of what the finance company itself may choose to term it, such liquidated damages cannot be excluded from the definition of the expression 'interest' under section 2(28A), as the definition is so exhaustive. The definition is so exhaustive as to include even any service fee or other charge that is levied in respect of the monies that remain unutilised.
- In certain cases, the lenders impose an obligation on the borrowers to pay the commitment charges, if after the sanction of the loan, the borrower could not make use of the funds upto a particular

point of time. The definition of the word 'interest' under section 2(28A) includes even such commitment charges. Therefore all the three authorities committed a mistake in understanding the scope of the expression 'liquidated damages' and in coming to a conclusion that the same would not come within the purview of the word 'interest' under section 2(28A).