No TDS from fees paid under Security Lending Scheme as payer wasn't aware of lender's identity

Summary – The Mumbai ITAT in a recent case of JM Financial Services Ltd., (the Assessee) held that where under SEBI's Securities Lending Scheme, assessee broker, at time of making payment of borrowing fee to intermediary or prior to it, was unaware of identity and other details of lenders, assessee could not have been fastened with liability of deduction of tax under section 194A

Facts

- The assessee was engaged in the business of capital market broker and other activities related to securities business. During the course of survey under section 133A, Assessing Officer noticed that for relevant year, the assessee, though, had debited an amount of Rs. 7.23 crores under the head finance cost, however, it did not deduct tax at source on such payment under section 194A. On seeking explanation, assessee submitted that the impugned amount was paid to National Securities Clearing Corporation Ltd. (NSCCL) under Securities Lending and Borrowing Scheme, 1997 (SLB) of Securities Exchange Board of India (SEBI) for enabling to settle short selling of securities and pursuant to an agreement with NSCCL being Approved Intermediary ('AI') of the SEBI, the transaction of lending and borrowing securities had to be carried out through it. Explaining the reason for non-deduction of tax at source, assessee submitted that the amount paid to NSCCL was not in the nature of income at its hands as NSCCL showed it as a liability in its books as they were to be paid to lending members. Thus, as per the assessee, since the identity of the persons to whom the amount was ultimately paid or credited was not known, TDS provisions could not be applied. Further, assessee took stand that the borrowing fee paid not being in the nature of interest, the provisions of section 194A would not be applicable.
- The Assessing Officer however observed that NSCCL was neither exempt from provisions of TDS under section 197(1) nor under any express or special provisions of TDS by way of CBDT Circular or Notification. The Assessing Officer took stand that since the payment made was on account of debt incurred in borrowing the securities for short selling in capital market, it would come within the definition of interest as provided under section 2(28A). Thus, holding assessee as an assessee-in-default, Assessing Officer raised demand of Rs. 72.32 lakhs under section 201(1) and levied interest thereupon under section 201(1A) amounting to Rs. 22.42 lakhs.
- On appeal, the Commissioner (Appeals) upheld order of Assessing Officer.
- On appeal to Tribunal:

Held

- The SEBI has formulated the Securities Lending Scheme, 1997 (SLB Scheme) for lending and borrowing of securities through an approved intermediary. As per the definition of Scheme, as provided under SLB Scheme, it involves lending of securities through an approved intermediary to a borrower under an agreement for specified period with the condition that the borrower will return

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equivalent securities of the same type or class at the end of the specified period along with the corporate benefit accruing on the securities borrowed. As per clause (3)(1)(e) of the Scheme, lender means a person who deposits the securities registered in his name or in the name of any other person duly authorised on his behalf with an approved intermediary for the purpose of lending under the Scheme. Borrower, as per clause 3(1)(c) of the Scheme means a person who borrows the securities under the Scheme through an approved intermediary. As per clause 3(1)(a) of the Scheme, approved intermediary means a person duly registered by the Board under the guidelines of the scheme through whom the lender will deposit the securities for lending and the borrower will borrow the securities. Clause 4(1) of the Scheme provides that both the lender and the borrower will separately enter into agreements with the approved intermediary for depositing the securities for the purpose of lending through approved intermediary and also for borrowing of securities through the approved intermediary. It further makes it clear that there shall be no direct agreement between the lender and borrower for the lending or borrowing of securities. Clause 4(2) of the Scheme provides that the beneficial interest arising out of lending the securities through approved intermediary along with corporate benefit shall accrue to the lender. Clause 4(4) of the Scheme clarifies that lending of securities under the Scheme through an approved intermediary shall not be treated as disposal of the securities. The Scheme also provides for payment of fee for borrowing securities. Thus, a reading of the Scheme as a whole would indicate that the entire transaction relating to lending and borrowing of securities has to be mandatorily carried out through the approved intermediary.

- In the instant case there is no dispute that the approved intermediary is NSCCL and lending and borrowing of securities for which the borrowing fee has been paid was carried out through NSCCL. The Assessing Officer has held the payment of borrowing fee to NSCCL to be taxable at the hands of NSCCL and accordingly raised the demand under section 201(1) and levied interest under section 201(1A). However, the Commissioner (Appeals) has correctly appreciated the role of NSCCL while holding that it only acts as an intermediary or facilitator of the transaction of lending and borrowing securities and the borrowing fee is not an income of NSCCL. In fact, NSCCL has also clarified the aforesaid factual position by stating that the borrowing fee received by it is being shown as a liability in its books of account. Thus, to that extent, now it is settled that the borrowing fee paid by the assessee cannot be treated as income of NSCCL requiring the assessee to deduct tax at source under section 194A. However, it is a fact on record, the ultimate beneficiary of the borrowing fee paid by the assessee is the lenders of the securities borrowed by the assessee through the approved intermediary. In other words, the borrowing fee paid by the assessee was ultimately received by the respective lenders of securities and NSCCL has only acted as a pass through entity. Thus, in effect, the borrowing fee paid by the assessee is to be treated as income of the lenders of securities borrowed by the assessee. The issue which arises for consideration is, whether the assessee can be held to be an assessee-in-default for not deducting tax at source under section 194A in respect of borrowing fee paid to the lenders through NSCCL. In this regard, it is the contention of the assessee

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from the very beginning that since the identity of the lenders are not known to the assessee it could not have deducted tax at source while making such payment. Thus, the TDS provisions become unworkable. However, though, the Assessing Officer has not at all dealt with the aforesaid contention of the assessee in depth, Commissioner (Appeals) has rejected the contention of the assessee by observing that all details relating to the lenders of securities and the respective transactions are available with NSCCL and, therefore, the assessee must also be aware of such informations relating to the lender of securities to whom the borrowing fee has ultimately been paid. On carefully scanning through the impugned order of the Commissioner (Appeals) no factual basis is found for the Commissioner (Appeals) to arrive at such a conclusion. As already discussed earlier, clause 4(1) of the Scheme mandates that the lender of securities and borrower of securities will have to enter into separate agreements with approved intermediary for lending and borrowing of securities. The Scheme specifically prohibits any direct agreement or contact between the lender and the borrower for lending and borrowing of securities. In fact, the code of conduct for approved intermediaries as per clause 11 clearly states that the approved intermediary shall maintain confidentiality of information about lender or borrower which it has come to possess as a consequence of dealing with it and shall not divulge the same to other clients, the press or any other interested parties.

- Thus, on a reading of the Scheme as a whole, it appears that the lender and borrower of securities have no contact with each other as the entire transaction is regulated through NSCCL. Keeping in perspective the aforesaid facts, the contention of the assessee that, while making payment of borrowing fee it was not aware of the identity and other details of the lender, assumes importance. The Commissioner (Appeals) has not referred to any material to demonstrate that at the time of making payment to the NSCCL or prior to it the assessee knew the identity and other details of the lenders to whom NSCCL was ultimately going to pay the borrowing fee. It further appears, neither the Assessing Officer nor the Commissioner (Appeals) have conducted any enquiry with the NSCCL for ascertaining the fact as to whether at the time of making the borrowing fee or prior to it assessee was in knowledge of the identity and other details of the lender. Ascertainment of these facts is of utmost importance since from the very beginning it is the consistent stand of the assessee that it is not aware of the identity and other details of the lenders to whom the borrowing fee is ultimately paid by the NSCCL. The contention of the assessee that, in the absence of availability of the identity and other details of the lender to whom the borrowing fee is ultimately paid by the NSCCL the assessee could not have complied the provisions of section 200(3) and section 203(1), has substantial force and cannot be brushed aside with some general observations. Since, the Departmental Authorities have not properly appreciated the contentions of the assessee and have not made any enquiry to ascertain the assessee's claim that at the time of paying borrowing fee, it has no knowledge or information about the identity and other details of lenders, this issue is to be restored to the file of the Assessing Officer for re-adjudication after proper enquiry.

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- In the event it is ultimately found that at the time of paying the borrowing fee to NSCCL or even prior to it, the assessee was unaware of the identity and other details of the lenders, then it cannot be fastened with the liability of deduction of tax under section 194A, since, the TDS provisions will become unworkable and the assessee cannot be compelled to perform an impossible act. As regards without the prejudice submissions of the assessee that the borrowing fee is not in the nature of interest, since the decision on the aforesaid issue will depend upon the ultimate outcome of the issue relating to assessee's claim that in the absence of identity of the payee could not have deducted tax at source, the issue cannot be decided at this stage and is restored to the Assessing Officer for deciding afresh, if warranted. Needless to mention, the Assessing Officer must afford a reasonable opportunity of being heard to the assessee.
- In the result, assessee's appeal is partly allowed for statistical purposes.

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