

## **Liquidated damages to finance co. is 'interest' income eligible to section 10(23G) exemption**

**Summary – The High Court of Madras in a recent case of Infrastructure Development Finance Co. Ltd., (the Assessee) held that ‘Liquidated damages’ paid by borrowers to finance company for default in payment of loan falls within purview of term ‘interest’ income under section 2(28A) eligible for exemption under section 10(23G)**

**Deduction of amount towards provisions for bad and doubtful debt under section 36(1)(vii)(c) is independent of deduction under section 36(1)(viii)**

### **Facts**

- The assessee was a public limited company incorporated with the main object of providing long-term finance to enterprises engaged in developing, maintaining and operating infrastructure projects and facilities. The assessee claimed exemption under section 10(23G) in respect of interest income earned by it from long-term finance provided to enterprises undertaking developing, maintaining and operating infrastructure facilities. It claimed exemption with respect to the liquidated damages which had been received from the borrowers on account of default on their part in making payments as per the terms of the loan agreements entered into by them with the assessee.
- The Assessing Officer held that the assessee was not entitled to exemption under section 10(23G) since the amounts earned by it did not constitute 'interest' as defined under section 2(28A).
- The Commissioner (Appeals) affirmed the decision of the Assessing Officer.
- On appeal, the Tribunal upheld the order of the Commissioner (Appeals).
- On appeal to the High Court :

### **Held**

- The liquidated damages earned by the assessee to an extent of Rs. 21,28,296 were admittedly on account of defaults committed by the borrowers. It is claimed that this income would not fall under the category income by way of dividends as provided under clause (23G) of section 10. As a matter of fact, it can be held that said income may not fall under the category of long-term capital gains etc. But the question whether such income earned by way of liquidated damages would fall under the category of interest, as stipulated under section 10(23G) or not, can be determined only on examining the definition of the expression 'interest' as provided under section 2(28A).
- An inference can be drawn that there are instances when lenders of money on long-term basis impose an obligation on the borrowers to pay commitment charges. This is necessitated since after the sanction of the loan, the borrower could not make use of the funds upto a particular point of time.

- To determine this aspect, reference may be drawn, with advantage, to the agreement which the assessee had entered into with its borrowers.
- As per one of said agreement, In the case of default in redemption of default payment of interest and all other monies (except liquidated damages) on their respective due dates, liquidated damages at the rate of 2.10 per cent per annum was levied and was payable by the borrowers for the period of default.
- It is also seen that arrears of liquidated damages shall carry interest at the rate of 2.5 per cent.
- It is, thus, seen that though the term liquidated damages is used in the agreement, it actually signifies interest claimed by the assessee. This term 'interest' would come within the word 'charge' as provided under the definition of 'interest' in the Act.
- Consequently, the three authorities had erred in understanding the scope of the expression 'liquidated damages' while coming to a conclusion that it would not come within the purview of the word 'interest' under section 2(28A).