
(2011) 10 DEL CK 0028
In the Delhi High Court
Case No : ITA 1543 of 2010

CIT

APPELLANT

Vs

Nectar Lifesciences Ltd.

RESPONDENT

Date of Decision : 20-10-2011

Acts Referred:

Income Tax Act, 1961 — Section 260A, 28, 37, 56, 57

Citation : (2011) 10 DEL CK 0028

Hon'ble Judges : Sanjiv Khanna, J;R.V. Easwar, J

Bench : Division Bench

Advocate : Anupam Tripathi, for the Appellant; S. Krishnan, for the Respondent

Judgement

1. The present appeal u/s 260A of the Income Tax Act, 1961 (Act, for short) filed by the Revenue relates to computation of deduction claimed by the assessee u/s 80HHC for the assessment year 2004-05.

2. Vide order dated 22nd February, 2011, the following question of law was framed:-

Whether on the facts and circumstances of the case, has the Hon"ble Tribunal not grossly erred in holding that the interest earned from the FDRs was profits derived from the export of activities and thus eligible for deduction u/s 80HHC particularly when it is in clear violation of the decision of the Hon"ble Supreme Court in the case of M/s Pandian Chemicals Vs. CIT.

3. By a separate order passed in today"s date we have disposed of

ITA 125/2009 between the Revenue and the respondent-assessee pertaining to the immediate earlier assessment year 2003-04. For the sake of convenience, we reproduce the entire order disposing of ITA 125/2009:-

On 28th August, 2009, the following questions of law were framed:-

a) Whether the Ld. ITAT has erred in law in the facts and circumstances of the

case in confirming the order of the CIT(A) whereby the CIT(A) held that since the interest paid on borrowed funds is more than the interest received on FDR, therefore, 90% of the gross interest received from FDR should not be reduced from the business income of the assessee for computing deduction u/s 80HHC"

b) Whether the Ld. ITAT was correct in law in holding that the interest on FDR should not be reduced from the business profits since the interest income is not assessed by the assessing officer under the head "Income from other sources"'''

2. The respondent-assessee is a company engaged in the business of manufacturing and sale of bulk drugs. It is also exporting drugs manufactured by them.

3. For the assessment year 2003-04, return of income declaring income of Rs. 4,81,84,570/- was filed on 2nd December, 2003. The respondent-assessee had claimed deduction u/s 80HHC of the Income Tax Act, 1961 (Act, for short) of Rs. 98,24,195/-.

4. The Assessing Officer noticed that the respondent-assessee had not reduced 90% of the miscellaneous income from the profit of business and a questionnaire dated 23rd January, 2006 was issued. The Assessing Officer observed that interest was earned on FDRs, which were kept with the bank as security under their lien for the opening of letter of credits. The Assessing Officer in the assessment order has further recorded as under:-

.....The letter of credit is the working capital facility extended by the bank for purchase of raw material and includes usage period of 60 days and 120 days. For accounting purposes it has been shown separately under the misc. income else it can be netted with the interest expenditure paid to the bank for working capital limits. hence, the same has direct nexus with the manufacturing and export business.

5. He thereafter computed deduction u/s 80HHC by excluding 90% of the miscellaneous income and including interest earned on FDRs. In the final computation made by the Assessing Officer, interest earned on FDRs mentioned above was treated as part of business income and not as income from other sources.

6. On appeal filed by the respondent-assessee, the CIT (Appeals) accepted the contention of the assessee that interest earned on FDRs should be set off or netted off, from the interest paid by the assessee to the bank. The CIT (Appeals) while accepting the contention of the assessee has recorded as under:-

1. Interest on FDR:

After examination of the documents filed by the assessee before me and as well as with the assessing officer I found that FDRs are purchased by assessee out of the borrowed fund and kept with Bank under security under their lien for the opening of letter of credit. Since the FDRs are purchased for business compulsion

therefore, in view of various legal pronouncement made and has also referred by the assessee about the considered view that assessee should be allowed, Netting of the interest received and paid for computing the business profit. Since interest on borrowed fund is higher than interest received therefore, 90% of the gross interest received from FDR should not be reduced from the business income of the assessee for computing deduction

u/s 80HHC of the Income Tax Act.

7. The Revenue filed an appeal before the Income Tax Appellate Tribunal (for short, the tribunal), but by the impugned decision dated 29th July, 2008, the said appeal was dismissed. While dismissing the appeal, the tribunal noticed and has observed that interest earned on the FDRs was not income from other sources, but had been treated as business income.

8. Mr. Tripathi, learned counsel appearing for the Revenue in the present appeal has submitted that interest earned on the FDRs should be treated as income from other sources and not income derived from export. He has referred to the decisions rendered in Pandian Chemicals Ltd. Vs. Commissioner of Income Tax, , K. Ravindranathan Nair v. Deputy Commissioner of Income Tax (Assessment) and Another [2003] ITR 669 (Ker.), South India Shipping Corporation v. Commissioner of Income Tax [1999] ITR 240 24 Mad , Commissioner of Income Tax Vs. Cosmos International, and Rishi Dev Batra Vs. Dr. (Mrs.) Anup Suri

9. The aforesaid contention of the appellant-Revenue was considered by this Court in Shri Ram Honda Equip (supra) and it has been held as follows:-

35. Turning to the submissions in the present cases, as regards the first of the categories, viz., the parking of surplus funds, there should be no difficulty at all. In view of the large number of the decisions of the hon"ble Supreme Court in the context of section 56 and section 57 and those of the Kerala High Court in the context of section 80HHC itself, we are unable to accept the contention of the assessee based on SNAM PROGETTI S.P.A. Vs. ADDITIONAL COMMISSIONER OF Income Tax, NEW DELHI-II, AND OTHERS., that interest earned on parked surplus funds should qualify as business income. Clearly, SNAM PROGETTI S.P.A. Vs. ADDITIONAL COMMISSIONER OF Income Tax, NEW DELHI-II, AND OTHERS., was not rendered in the context of section 80HHC and cannot but be confined to the facts of that case. Circular No. 564, dated July 5, 1990 (see [1990] 184 ITR 137), can also not help in interpreting section 80HHC which is a "stand alone" provision. We are, therefore, of the view that where surplus funds are parked with the bank and interest is earned thereon it can only be categorised as income from other sources. This receipt merits separate treatment u/s 56 of the Act which is outside the ring of profit and gains from business and profession. It goes entirely out of the reckoning for the purposes of section 80HHC. To give effect to this position, the Assessing Officer while computing profits of the export business will have to remove from the debit side of the profit and loss account the corresponding interest expenditure that has been "laid out" to earn such income

from other sources. Otherwise this will depress the profits by an amount which is out of the reckoning of section 80HHC, a consequence not intended to be brought about.

36. The other category is where the exporter is required to mandatorily keep monies in fixed deposit in order to avail of credit facility for the export business. The argument on behalf of the assessee is that but for such a stipulation by the bank there was no need for the exporter to keep the money in fixed deposit and therefore the income earned from such fixed deposits bears a direct nexus to the business activity itself. Given the repeated affirmation by the hon'ble Supreme Court of three judgments of the Kerala High Court on the same issue, we are inclined to follow the view expressed by the Kerala High Court on each of these occasions. We accordingly hold that interest earned on fixed deposits for the purposes of availing of credit facilities from the bank, does not have an immediate nexus with the export business and therefore has to necessarily be treated as income from other sources and not business income. Question (a) and issue (i) are answered accordingly.

10. Thereafter, the Division Bench examined the question of netting of interest under Clause (bba) of the Explanation to Section 80HHC. Learned counsel for the Revenue is, therefore, right in his contention that interest income earned from the FDRs does not qualify for deduction u/s 80HHC of the Act, but has ignored the findings of the Division Bench in Shri Ram Honda Equip (supra) on the question of netting of interest, if the interest earned on FDRs has nexus with the export business of the assessee for the purpose of Clause (bba) of the Explanation to Section 80HHC. It is the second aspect which is relevant and material in the present case.

11. After examining the said provision and several judgments, the Division Bench in Shri Ram Honda Equip (supra), in conclusions (v) to (ix) has held as under:-

(v) Interest earned on fixed deposits for the purposes of availing of credit facilities from the bank, does not have an immediate nexus with the export business and therefore has to necessarily be treated as income from other sources and not business income.

(vi) Once business income has been determined by applying accounting standards as well as the provisions contained in the Act, the assessee would be permitted to, in terms of section 37 of the Act, claim as deduction, expenditure laid out for the purposes of earning such business income.

(vii) In the second stage, the Assessing Officer will deduct from the profits of the business computed under the head "Profits and gains of business or profession" the following sums in order to arrive at the "profits of the business" for the purposes of section 80HHC(3) :

(a) 90 per cent. of any sum referred to in clauses (iiia), (iiib) and (iiic) of section 28 i.e., export incentives;

(b) 90 per cent. of any receipts by way of brokerage, commission, interest, rent, charges or

any other receipt of a similar nature included in such profits; and

(c) profits of any branch, office, warehouse or any other establishment of the assessee situate outside India.

(viii) The word "interest" in clause (baa) of the Explanation connotes "net interest" and not "gross interest". Therefore, in deducting such interest, the Assessing Officer will take into account the net interest i.e., gross interest as reduced by expenditure incurred for earning such interest. The decision of the Special Bench of the income tax Appellate Tribunal in *Lalsons* [2004] 89 ITD 25 (Delhi) to this effect is affirmed. In holding as above, we differ from the judgments of the Punjab and Haryana High Court in *Rani Paliwal Vs. Commissioner of Income Tax*, and the Madras High Court in *Commissioner of Income Tax Vs. V. Chinnapandi*, and affirm the ruling of the Special Bench of the income tax Appellate Tribunal in *Lalsons* [2004] 89 ITD 25 (Delhi).

(ix) Where, as a result of the computation of profits and gains of business and profession, the Assessing Officer treats the interest receipt as business income, then deduction should be permissible, in terms of Explanation (baa) of the net interest, i.e., the gross interest less the expenditure incurred for the purposes of earning such interest. The nexus between obtaining the loan and paying interest thereon (laying out the expenditure by way of interest) for the purpose of earning the interest on the fixed deposit, to draw an analogy from section 37, will require to be shown by the assessee for application of the netting principle.

12. Referring to the aforesaid conclusions, another Division Bench of this Court in *Commissioner of Income Tax v. Shahi Export House* [2010] 195 Taxman 163 (Del) has held as under:-

7. A conjoint reading of conclusion Nos.1,4, 5 and 6 and particularly No.5 would clearly demonstrate that only in those cases where interest earned on fixed deposits have an immediate nexus with the export business would be treated as income from business and interest earned on fixed deposits which does not have an immediate nexus with the export business, it would be treated as income from other sources. The court opined that when the interest was earned on the fixed deposits for the purposes of availing of credit facilities from the bank, it did not have such a nexus with the export business and therefore, had to be necessarily treated as income from other sources and not the business income.

8. Thus, insofar as earning of interest on fixed deposit is concerned, the determinative test is as to whether such interest has "immediate nexus" with the export business.

13. In the present case we are concerned with the situation where the Assessing Officer himself has treated interest earned on the FDRs, which were given to the bank as security to avail of the credit facility, as business income and exports.

The Assessing Officer has himself held that the FDRs were used to avail the working capital limits. In the assessment order it is not stated or even alleged that the said credit facilities from the bank had no nexus with the export business. On the other hand, it is stated that they had nexus with the letter of credit and the Assessing Officer has held that they had direct nexus with manufacturing and export business. A similar view has been taken by Delhi High Court in Commissioner of Income Tax v. Punjab Stainless Steel Ind. (2007) 162 Taxman 9 (Del) and Commissioner of Income Tax v. Anand Kumar [2007] 164 Taxman 330 (Del).

14. In view of the aforesaid legal position and the admitted facts, the question of law is answered against the appellant-Revenue and in favour of the respondent-assessee. The appeal is accordingly disposed of without any order as to costs.

4. Learned counsel appearing for the Revenue submitted that the aforesaid order passed in ITA 125/2009 should not be followed in the present case as the interest earned on the FDRs was not treated as business income by the Assessing Officer and the CIT (Appeals) in the present case. The relevant portions of the assessment order and the order of the CIT (Appeals) read as under:-

Assessment order

5. I have considered the reply of the assessee on merits of the case. Assessee could not submit anything to prove direct nexus of FDR's and it's business income. The FDR's have been made with earlier years surplus funds if the assessee. On this issue there is settled position of law in view of the various judicial pronouncements including the judgment of Hon'ble Kerala High Court in the case of K. Ravindranathan Nair Vs. Deputy Commissioner of Income Tax and Another, , which has been affirmed by the Hon'ble Supreme Court by dismissing the SLP filed by the assessee against the judgment, the interest income on FDR's amount to Rs. 42,42,898/- is treated as income of the assessee under the head "Income from other sources" and accordingly, disallowed for the purpose of benefit of deduction u/s 80HHC within the meaning of explanation (bba) below section 80HHC(4C) of the I.Tax Act.

Order of the CIT (Appeals)

I have examined the submission of the appellant and the observation made by the Assessing Officer in the assessment order. Vide para 5 of the Assessment Order, the A.O. has observed that appellant could not submit anything to prove direct nexus between the interest received on FDR's and cash credit facility taken by it. The F.D.Rs. have been made with earlier years surplus funds available with the appellant. During the course of appellate proceedings, the appellant filed letters from Punjab National Bank, Sector 16, Chandigarh Branch and State Bank of India, wherein Fixed Deposits of Rs. 3,05,05,850/- and Rs. 2,19,58,524/- have been got issued, continued or renewed during F.Y. 2001-02 to 2003-04. In both the certificates, it is mentioned that "FD"s have been got

issued, continued or renewed for the F.Y. 2003-04 for the C.C. A/c No.05755008700004684 of the holder of M/s Nectar Life Sciences Ltd. and C.C. A/c No.10214998738. This shows that these fixed deposits were taken in the earlier years and were renewed in F.Y. 2001-02, 2002-03 and 2003-04 for their Cash Credit accounts running with the said banks. This clearly shows that the Fixed deposits were already in existence and were not taken out of the loan taken from the bank in the form of cash credit. There is no nexus between the loan facilities availed by the appellant and the amount invested in fixed deposit. Nothing has been produced neither before the A.O. nor before me to prove any nexus between the interest income and the interest expense.

5. It may be noted here that when the matter was taken up by the assessee to the tribunal, the tribunal by the impugned order dated 13th August, 2009, followed its earlier order for the assessment year 2003-04.

6. We have examined the orders passed by the Assessing Officer and the CIT (Appeals), relevant portions of which have been quoted above. The order passed by the Assessing Officer is cryptic and does not give any details and even deal with the reasons/grounds mentioned by the Assessing Officer in the preceding year in which it was held that the interest earned on the FDRs was business income. The finding recorded by the Assessing Officer that the FDRs had been made with the earlier years' surplus funds is without any basis or foundation. He has not even dealt with and examined the contention that the FDRs were given as security for availing cash credit limit. The said aspect has been referred to and accepted by the CIT (Appeals) in his order quoted above. CIT (Appeals) has also accepted that these FDRs were taken in the earlier years for cash credit account maintained for business purposes with the banks. He, thereafter, immediately in the next sentence had drawn the inference that the FDRs were already in existence and were not made from of the loan taken from the bank in the form of cash credit and, therefore, there was no nexus between the loan facility and the amount invested in the FDRs and the assessee had not been able to prove nexus between interest income and the loan. The aforesaid inference drawn by the CIT (Appeals) has no basis or foundation. The said finding is an unfounded assumption based on surmises. There is no indication or basis to draw the said inference logically on the facts, material or record before him and adverted to in the order. These findings are contrary to the findings of the income tax authorities in the preceeding year quoted above

7. In these circumstances, we do not find that there is any difference between the case for the assessment year 2003-04 and the present case relating to the assessment year 2004-2005. The question of law is accordingly answered against the Revenue and in favour of the assessee. The appeal is disposed of. No costs.