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In the Andhra Pradesh High Court

Case No : Referred Case No. 116 of 1995

Commissioner of Income Tax — APPELLANT

Vs

Bakelite Hylam Ltd. — RESPONDENT

Date of Decision : 16-06-2006

Acts Referred:
Income Tax Act, 1961 — Section 80HH, 80HHC

Citation : (2006) 287 ITR 75

Hon'ble Judges : G. Chandraiah, J;Bilal Nazki, J

Bench : Division Bench

Advocate : S.R. Ashok, for the Appellant; S. Ravi, for the Respondent

Judgement

Bilal Nazki, J.—The question referred in this reference is:

Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that interest and other income aggregating to Rs. 451.4 lakhs was includible under the head ''Profits and gains of business'' and were to be taken into consideration for computing deduction u/s 80HHC of the Income Tax Act, 1961 ?

2. The Tribunal has allowed the appeal of the assessee and held that the interest and other income aggregating to Rs. 451.4 lakhs was includible under the head "Profits and gains of business" and was to be taken into consideration for computing deduction u/s 80HHC of the Income Tax Act, 1961. The Revenue objected to the order of the Tribunal and reference was accordingly made.

3. Admittedly the income was sought to be included under the head "Profits and gains of business" and computed in terms of Section 80HHC of the Income Tax Act, 1961 (for short "the Act"). Section 80HHC of the Act lays down:

80HHC. (1) Where an assessee, being an Indian company or a person (other than a company) resident in India, is engaged in the business of export out of India of any goods or merchandise to which this section applies, there shall, in

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accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction to the extent of profits, referred to in Sub-section (1B) derived by the assessee from the export of such goods or merchandise ; ....

4. From a bare perusal of this provision it appears that the income which is understood to be computed under this provision must have been derived by the assessee from the export of such goods or merchandise. Admittedly the income was not derived by export of goods or merchandise. Therefore, in our view, the Tribunal was not right in holding that the interest and other income aggregating to Rs. 451.4 lakhs were includible under the head "Profits and gains of business" and were to be taken into consideration for computing deduction u/s 80HHC of the Act. We are fortified in our view by various judgments of other High Courts.

5. A Division Bench of the Kerala High Court in Nanji Topanbhai and Co. Vs. Assistant Commissioner of Income Tax and Others, was considering the question as to whether the interest earned on fixed deposit was income arising out of export or income from other sources. The High Court held (headnote):

Under Section 80HHC of the Income Tax Act, 1961, the assessee who is engaged in export business is allowed, in computing the total income, a deduction out of the income derived from the export of such goods. Unless the assessee is able to show that the income received by way of interest from the fixed deposit is derived from the export business, it will not be entitled to claim deduction u/s 80HHC in respect of it.

6. In another judgment reported in Commissioner of Income Tax Vs. Cochin Refineries Ltd., the Kerala High Court held (page 352):

Profits and gains are well understood to mean only the business income, and not any other income. So long as the company has no business of lending money, and so long as the admitted case of the company is that the income derived is only on account of the peculiar situation arising from the time schedule for repayment of the loans, it cannot be stated that the income yielded by the deposits or investments was received in the course of the company''s business so as to be treated as a business profit.

7. In the present case it is nowhere stated that the amounts received were during the course of the business. The reasoning given by the Tribunal is on page 3 of its order and a paragraph from the order of the Tribunal is reproduced below:

The interest income of Rs. 380.58 lakhs represented interest received by the company on inter-corporate deposits or short-term loans given from time to time. Interest received from the customers for delayed payments, interest on security deposits made by the company with electricity board and other Government agencies in the normal course of its business and interest from investment deposit accounts. The learned Commissioner of Income Tax was of the view that these interest incomes do not form part of the business income.

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Further such income has been separately shown in the profit and loss account. There is force in the contention of Sri B. Shankar, the learned chartered accountant-cum-director for the assessee that the interest receipts would properly fall for consideration under the head ''Income from business'' as such interest receipts arose in the normal course of the business transactions of the assessee. The assessee has been borrowing from banks and financial institutions on payment of interest; the funds thus borrowed as well as the funds generated in the course of business were invested for short periods in sister concerns and other institutions for further utilisation in business. Further, the assessee is an existing concern and it is not the case of receipt of interest during the pre-commencement period ; nor is it a case of investment of share capital funds in the pre-commencement period. This is a case of investment of funds generated in the business as well as from out of the funds borrowed in the course of the business and, therefore, the income arising from such investments is to be properly set off against the interest payments made by the assessee in the course of its business. The transactions of interest payments and interest receipts in the context of a continuing business are interlinked and interrelated to each other and therefore they have to be looked upon as both sides of the same coin or as part of the same business transaction. Hence the income by way of interest received from delayed payment on the part of the customers, from deposits made with the electricity board and other Government agencies for purpose of business from inter corporate deposits made in the course of its dealing with the sister concerns and interest from short-term bank deposits are, in the fitness of things, to be considered as in the course of the business of the assessee itself-an existing business- and, therefore, the learned Assessing Officer had rightly considered the same as part of the business income even though such income was disclosed separately in the annual accounts of the assessee-company in order to comply with the provisions of the Companies Act.

8. In our view, there are no valid reasons given by the Tribunal for coming to the conclusion that these amounts which were earned by way of interest could be computed and given the benefit u/s 80HHC of the Act.

9. Another judgment to which reference made is Commissioner of Income Tax Vs. Kantilal Chhotalal, . This is a judgment by a Division Bench of the Bombay High Court. The facts in this case were that whenever a foreign buyer approached the assessee who himself was not able to supply the diamonds, the assessee would approach other diamond traders. The said traders would, thereafter send the goods to the foreign buyer on approval basis. If the foreign buyer approved the goods, the sale would take place directly between the trader and the foreign buyer for which the assessee would get one per cent, commission named as reassortment. The said reassortment charges were essentially the commission received by the assessee from the local parties in India from their sale. The question before the court was whether these profits could be given the benefit u/s 80HHC of the Act. This judgment held that such income could not be included in the business profits under the formula prescribed

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u/s 80HHC of the Act.

10. Learned Counsel for the assessee has drawn our attention to Clause (baa) of the Explanation to Section 80HHC of the Act inserted by the Finance (No. 2) Act, 1991, which was added by way of an amendment after the assessment order in question. This was also taken into consideration by the Bombay High Court and the High Court held (page 441):

In fact, the Legislature have clarified that receipts like interest, commission, etc., have no nexus with the export activity and by including such receipts in the business profits the existing formula became unworkable. Hence, by the amendment, such receipts were excluded. Moreover, the clarification has been introduced by way of Clause (baa) in the Explanation. Hence, the said amendment was clarificatory in nature. It cannot be disputed that there were several conflicting orders passed by the Department as the position was not clear. Hence, the amendment has come into force from April 1, 1992. However, the said amendment is clarificatory in nature. Even without the amendment, with the inclusion of the above receipts in the business profits, the formula became unworkable because the assessees introduced receipts in the business profits which had no nexus with the export activity.

11. In Commissioner of Income Tax Vs. K.K. Doshi and Co., the assessee was engaged in the manufacture and export of polished diamonds and the amounts collected as service charges when the assessee was not engaged in the activity of manufacture and export, were sought to be given the special deduction u/s 80HHC of the Act. The Bombay High Court held that it had no direct nexus with the export activity and therefore could not be taken into account u/s 80HHC of the Act.

12. In CIT v. Madras Motors Ltd./M.M. Forgings Ltd. the Madras High Court gave the following reason (page 68):

Let us now consider the interest earned by the assessee on the belated payments. There can be no doubt that this interest would, however, be directly relatable to the business of the assessee of forgings. If the purchasers of the forgings did not make the payments for the forgings and then agree to pay the interest on the delayed payments, the said interest would have direct nexus with the business of forgings. The true test would be whether such interest would be available to the assessee otherwise also. The answer to the question would be certainly in the negative. The interest being directly relatable only to the amounts receivable by the assessee during the course of its business on account of the sale of forgings, this interest would have to be included as the profits and gains derived from the business of the assessee. We hold that this part of the interest would be entitled to be covered by Section 80HH of the Act.

13. But on the facts this case is not similar to the case on hand. We have already drawn a paragraph from the judgment of the Tribunal and the facts had not revealed that the interest was earned because of the delayed payments. On the

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other hand, there is a finding that the funds generated in the course of the business were invested for short periods in sister concerns and other institutions for further utilisation in business. As such this judgment would not apply.

14. For the reasons given hereinabove, we are of the view that the Tribunal was wrong in giving the benefit u/s 80HHC of the Act, and in computing the income of Rs. 451.40 lakhs earned as interest for the purpose of computing deduction u/s 80HHC of the Act. The reference is answered in favour of the Revenue and against the assessee.

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