
(2012) 09 BOM CK 0014
In the Bombay High Court
Case No : IT Ref. No. 63 of 1996

Tanna Exports Ltd.

APPELLANT

Vs

CIT

RESPONDENT

Date of Decision : 18-09-2012

Acts Referred:

Income Tax Act, 1961 — Section 14, 147, 148, 256(1), 4

Citation : (2012) 09 BOM CK 0014

Hon'ble Judges : S.J. Vazifdar, J;M.S. Sanklecha, J

Bench : Division Bench

Advocate : Percy Pardiwalla with B.D. Damodar, for the Appellant; Suresh Kumar, for the Respondent

Judgement

S.J. Vazifdar, J.—This is a reference u/s 256(1) of the IT Act, 1961 arising out of the order of the Tribunal dated 23-11-1994 in ITA No. 763/Bom/1992 pertaining to the assessment year 1989-90. The Tribunal on the assessee's application drew up the statement of claim (case) and framed the following question for the opinion of this Court:

Whether on facts and in the circumstances of the case, the Tribunal was justified in law in holding that while computing the profits for the purpose of deduction u/s 80HHC, interest income of Rs. 40,20,418 was required to be excluded ?

The applicant-assessee is engaged in the business of export, inter alia, of rice, green peas and hardware. The assessee filed its return of income of Rs. 8,44,690 on 31-10-1989 and a revised return on 7-3-1990, declaring an income of Rs. 4,46,920. The AO, by an order dated 21-1-1991, assessed the total income at Rs. 48,05,374. The difference arises on account of the determination of the deduction u/s 80HHC.

2. Along with his return, the assessee filed a certificate, calculating the deduction u/s 80HHC at Rs. 3,08,19,854. The assessee received Rs. 40,20,418 towards interest in the circumstances we will refer to later and a sum of Rs. 4,64,700 by

way of liquidated damages. This reference is concerned only with the amount received towards interest. The question is whether the amount received towards interest ought to be added to the total turnover or not. For the purpose of the deduction u/s 80HHC, the assessee took the profit from the business at Rs. 3,12,17,908, which included the interest received. The AO sought the details of the interest. The information revealed that almost the entire interest was received from their sister-concerns. A paltry amount of Rs. 1,849 was received on account of the deposit for a car. The AO treated the interest as "income from other sources" and computed the deduction u/s 80HHC at Rs. 2,68,60,683. The AO calculated the profit derived from export for determining the benefit u/s 80HHC, applying the prescribed formula:

This reference concerns only the business profit variable. The AO took the business profit to be Rs. 2,72,07,602. The assessee, however, contended that to this figure ought to be added the interest derived as aforesaid of a sum of Rs. 40,20,418.

2. We will presume that section 80HHC, as it stood prior to 1-4-1989 amendment, is applicable. Section 80HHC then read as under:

80HHC. Declaration in respect of profits retained for export business.-

(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 accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction equal to the aggregate of-

(a) four per cent of the net foreign exchange realisation; and

(b) fifty per cent of so much of the profits derived by the assessee from the export of such goods or merchandise as exceeds the amount referred to in cl. (a):

Provided that the deduction under this sub-section shall not exceed the profits derived by the assessee from the export of such goods or merchandise:

Provided further that an amount equal to the amount of the deduction claimed under this sub-section is debited to the P&L a/c of the previous year in respect of which the deduction is to be allowed and credited to a reserve account to be utilised for the purposes of the business of the assessee.

(3) For the purposes of sub-s. (1), profits derived from the export of goods or merchandise out of India shall be,--

(a) in a case where the business carried on by the assessee consists exclusively of the export out of India of the goods or merchandise to which this section applies, the profits of the business as computed under the head Profits and gains of business or profession;

(b) in a case where the business carried on by the assessee does not consist exclusively of the export out of India of the goods or merchandise to which this section applies, the amount which bears to the profits of the business (as computed under the head Profits and gains of business or profession) the same proportion as the export turnover bears to the total turnover of the business carried on by the assessee.

By an amendment to section 80HHC(1), which came into effect from 1-4-1989, the second proviso was deleted.

3. We will, as we said, presume for the purpose of this reference that the second proviso was to be complied with by the assessee. We will also presume that the assessee had complied with the second proviso viz. that an amount equal to the amount of the deduction claimed u/s 80HHC(1)) was debited to the P&L a/c of the previous year in respect of which the deduction was to be allowed and credited the same to a reserve account. It is important to note that the second proviso further provided that the amount credited to the reserve account was to be utilized for the purpose of the business of the assessee. The question is whether this was done.

4. The applicant, therefore, in order to avail of the benefit of section 80HHC, in accordance with the second proviso thereof, created a reserve in its balance sheet. The reserve was not distributed among the partners which resulted in the yield by way of interest which was credited to the P&L a/c. The extra capital was created because the reserve was not required for the purpose of the applicants export business. In view of the various authorities cited before us, it is of vital importance to note that the assessee contended, as recorded, inter alia, in para 2 of the order of the Tribunal that the extra funds available because of the reserve not being required for the purpose of the assessee's export business was invested elsewhere viz., with the sister-concerns and the applicant earned interest income on such investment.

5. Mr. Pardiwalla, the learned senior counsel appearing on behalf of the applicant firstly contended that interest need not be from money lending business alone for it to constitute business income. Secondly, he submitted that if the source of funds which are invested, is from a business activity, any accretion thereto or in respect thereof, including interest, must be held to be business income. Thirdly, he submitted that if the investment is held to be for the purpose of the business of the assessee, it would normally follow that accretions thereto, including by way of interest, constitute the assessee's business income.

6. The first submission really does not arise for we did not understand Mr. Suresh Kumar as having disputed the proposition that interest need not be only from the business of money lending to constitute it as business income. If, for instance, an assessee is involved in the business of investments, any profit in respect thereof, including by way of interest would constitute business income. That, however, does not carry the assessee's case any further. In the present case, the AO and

the appellate authorities have rightly not accepted the assessee's contention that it was involved in the business of investments.

7. Mr. Pardiwalla relied upon the pattern of investments in support of his contention that the assessee is involved in the business of investments. He relied upon the following investments made by the assessee:

8. The CIT(A) came to a finding of fact that the applicant was neither in the business of money lending nor in the business of regularly investing its moneys as loans and advances to other parties. The CIT(A) found as a fact that interest income earned by the assessee on the loans cannot be termed as business income. The Tribunal upheld this finding observing that there was no element of business of lending money. The Tribunal held that there was no systematic or organized activity like money lending.

9. Firstly, both the appellate authorities have come to a finding of fact. We are unable to hold that these findings are perverse.

10. Further, even assuming that we are entitled to question these findings of fact, we are not inclined to disagree with the authorities. The mere fact that the assessee invested the said amounts with their sister-concerns for five years does not indicate, much less establish, that they were engaged in the business of lending or investing money. We hasten to add that merely because the investments have been made with the sister-concerns would not be decisive of whether the assessee is engaged in the business of lending or investing money. There may well be cases where assessee's carrying on the business of investments, invest in their group companies or sister-concerns. If it is part of a business decision taken in respect of the business of investments or lending, any returns even from group companies or sister-concerns, may well constitute the assessee's business income and not chargeable to tax under the head "Income from other sources".

11. However, in the present case, there is nothing to indicate that the said investments were pursuant to or in furtherance of any such business activity or decision of the assessee. There is nothing to indicate that the assessee carried on such business and invested only in its sister-concerns. In fact, the case pleaded before the Tribunal was to the contrary. As we indicated earlier, the case before the Tribunal as recorded in para 2 of the order was as follows:

(iv) Extra capital was created because of this reserve. Since such capital was not required for the purposes of the appellants' export business, it was invested elsewhere and the appellant earned interest income on such investment.

Thus, on the assessee's own admission, there is no factual basis for Mr. Pardiwalla's first submission. Although the assessee stated that the capital was not required for the export business, it is pertinent to note that they have not established that it was either required or utilized for any other business of theirs--lending, investment or otherwise. Indeed, this admission affects the other

submissions as well.

12. Mr. Pardiwallas next submission is that if the source of funds which are invested, is from a business activity, any accretion thereto or in respect thereof, including interest, must be held to be business income.

13. Mr. Pardiwallas reliance upon the judgment of this Court in Commissioner of Income Tax, Pune Vs. Hindustan Antibiotics Ltd., is not well founded. It is important to note that the Court found that the assessee had accumulated large funds to finance the entire cost of a plant which, in fact, was commissioned in the subsequent years. The same was a normal feature of the assessee's business. The accumulated amounts were kept in fixed deposits in order to earn interest to raise the profit of the assessee until the funds accumulated could be used for the assessee's business as contemplated. The authorities accepted these findings but despite the same, upheld the deduction made by the ITO. The Division Bench held that the assessee had, in fact, accumulated and retained the amounts for the purpose of its future expansion out of profits earned during the year. The Division Bench held as follows:

Can a company like the assessee-company, which accumulates and retains for the purposes of its future expansion large amounts out of the profits earned during the year, be said to have accumulated these amounts for purposes other than its business? Indeed, any such contention would appear ridiculous when so put. These are what are known in business parlance as retained profits. Retained profits may be retained for the purpose either of meeting and reducing the present liabilities or for meeting the working capital required in praesenti or for the reduction of loans and borrowings or for a future expansion of the company. Regarded in any of these ways, such retained amounts must be regarded as moneys required for the purpose of the business of the company like the assessee-company.

14. A mere investment of amounts from time to time even over years does not necessarily lead to the conclusion that the same is pursuant to any consistent business activity. It is always possible that an assessee regularly invests its excess capital only for the purpose of ensuring that the money earns interest without being involved in the business of lending or investing money.

15. (A) The judgment of this Court in Commissioner of Income Tax Vs. Indo Swiss Jewels Ltd. and Another, is of no assistance to the assessee either. In that case the Tribunal, contrary to the AO, accepted the assessee's explanation for the investment from which the interest in question had been earned. It was found that the amounts had been invested to enable the assessee to import machinery for which orders had already been placed. The surplus funds available with the assessee were kept apart for the same. As the order for the machinery was placed outside India, the money had been kept ready for payment upon the shipments arriving. To ensure that the moneys did not lie idle, they were invested in inter-corporate deposits which carried 18 per cent interest, whereas

the rate of interest for deposits with banks was only 11 per cent. The Division Bench held:

6. Though the AO did not accept the explanation of the assessee, the appellate authority in the facts of the case and in the light of the material placed by the assessee on record, was satisfied that the funds were kept by the assessee in the various companies for short-terms for payment for imported machinery. In this connection the appellate authority held that the balance-sheet for the next year also showed that all these deposits were withdrawn and paid for the machinery. The appellate authority was satisfied with the explanation put forth by the assessee. The Tribunal did not find any error in the approach of the appellate authority. That the machinery was in fact imported by the assessee is not in question. From the facts and circumstances of the present case it is clear that the inter-corporate deposits were made by the assessee from the surplus funds that were set apart for the payment of imported machinery. That the said deposits were withdrawn and payment was made towards import of the machinery is also not questioned by the Revenue. The interest earned on the short-term deposits of the money kept apart for the purpose of business has to be treated as income earned on business and cannot be treated as income from other sources.

(B) There was thus a finding of fact that the interest earned was in respect of the deposits which had been kept for the purpose of the business and, therefore, the Division Bench held that interest thereon must be treated as income earned from business and not as income from other sources. In the case before us, the investment with the sister-concerns had no nexus to the assessee's business activities. They were merely invested for the purpose of earning interest. The judgment does not support the extreme proposition that if the source of funds which are invested is from the business activity, the accretion thereto, including by way of interest must be held to be business income. The funds may well have been earned from an assessee's business activities. The same may, however, be invested for purposes entirely alien to the assessee's business. It can hardly be suggested then that the interest earned on such investments fall under the head "Business income".

16.(A) In *Shree Krishna Polyester Ltd. Vs. Deputy Commissioner of Income Tax*, , the question was whether the income received by the assessee on the surplus money from public issue of shares invested in bank deposits for a period of 45 days was assessable under the head "Income from other sources". The Tribunal found that the assessee was engaged in the business of manufacture of synthetic yarn and that money lending had never been its business activity. The Division Bench held that merely because an assessee carries on business, it does not mean that all income received by him is business income since he may have income that may be classified under different heads as set out in s. 14. It was held that the facts established that the interest earned from the investment "did not spring or emanate from the business activity of the assessee". The Division

Bench held:

The interest income in respect of the surplus money not required for business immediately and deposited in banks as idle money, in our opinion, would be assessable as income from other sources in the facts and circumstances of the present case.

This observation, in fact, militates against Mr. Pardiwallas submission. In the case before us also, it is not the assessee's case that the surplus money was required for business immediately. In any event, the facts do not establish the same. This Court, therefore, dismissed the assessee's appeal holding that the interest earned was assessable as income under the head "Income from other sources."

(B) Mr. Pardiwalla, however, relied upon the following observations in para 12 of the judgment which read as under:

From what we have discussed above, in the facts and circumstances of the present case, it cannot be said that the surplus funds available with the assessee acquired in public issue were funds acquired from the business activity and when it is not so, the interest earned thereon in short-term deposit cannot be treated as business income and has to be treated as income from other sources....

He submitted that these observations implied that when the funds that are invested are acquired from the business activity, the interest earned thereon ought to be treated as "business income". The submission is not well founded. We do not read this to be the ratio of the judgment. In fact, the earlier observations of the Division Bench, which we have referred to, indicate the contrary. They are not restricted to the source of surplus money. In other words, the Division Bench did not hold that only when surplus money not acquired from the business activity is invested, the interest thereon cannot be considered to be business income. In other words, the observations are made irrespective of the source of the surplus money to wit irrespective of whether the surplus money is earned on account of the business activity of the assessee or otherwise.

17. This brings us to Mr. Pardiwallas third submission viz. if the investment is held to be for the purpose of business of the assessee it would follow, at least normally, that accretions thereto, including by way of interest, constitute the assessee's business income. In support of this submission, he relied upon the judgment in CIT v. Indo Swiss Jewels Ltd. (supra), and in particular para 6 thereof, which we have extracted above.

The judgment, however, does not apply in the facts of this case as it has not been established that the investment with the sister-concerns was for the purpose of the assessee's business. In addition to what we have said in this regard, it is pertinent to note that the assessee has not even established that one of its business activities was to advance loans to third parties and/or to invest its funds and that it was a mere coincidence that over the years, all the advances were made to and the investments were made in their sister-concerns.

The assessee has not established that in view of the market situation or for any stated/disclosed commercial reasons, it found it convenient and profitable to carry on these activities only with and/or through the sister-concerns. Thus, the factual basis for the submission being absent, we are not inclined to accept the same.

18. Mr. Pardiwallas reliance upon the judgment of this Court in Commissioner of Income Tax Vs. Lok Holdings, is not well founded either. In that case, the assessee, a firm involved in the business of developing properties, received moneys in advance from its customers who had purchased flats in the properties developed by them. The surplus amount which could not immediately be utilized in the business were temporarily invested with banks and other concerns. The deposits, with accrued interest, were deducted from the work-in-progress till the conclusion of the project. The AO assessed this interest income as "income from other sources". The CIT(A) deleted the same and the Tribunal upheld the order of the CIT(A). The Division Bench dismissed the appeal against the order of the Tribunal holding that the questions of law raised would not arise.

Thus, a question of law was not decided. From the judgment, it is difficult to ascertain whether or not the investment was for the purpose of the business of the assessee or that the accretions thereto were to be utilized for the business of the assessee in praesenti or even in the near future. Moreover, Mr. Pardiwalla, with his usual fairness, invited our attention to a judgment of this Court in Commissioner of Income Tax Vs. Swani Spice Mills P. Ltd., , which dealt with this judgment. We will refer to these passages after setting out the main observation of this Court.

19. In CIT v. Swani Spices Mills (P) Ltd. (supra), this Court reviewed a long line of judgments on this issue and held:

20. These judgments of the Supreme Court establish that the income of an assessee which is chargeable to tax under s. 4 is required for the purposes of computation to be classified under various heads of income specified in s. 14. Sec. 56 which deals with income from other sources is attracted where the income does not belong to a category which is specified in any of the other heads elucidated in s. 14. Income earned by an assessee, which utilizes its surplus funds in order to earn interest cannot be classified under the head of business income but will fall for classification as income from other sources....

27. Ordinarily, where an assessee invests funds surplus to the business and earns interest, such income does not constitute business income but falls under the head of income from other sources. Merely because an assessee carries on business and the income of the business is invested in deposits, that would not result in an inference that the return on the investments must partake of the character of business income. Every income which is earned by an assessee who carries on business is not business income. On the contrary, the position in law is that it is only where income earned on account of interest springs out of or

emanates from the business activity of the assessee, that this income can be regarded as being of the nature and character of business income....

35. The consistent line of reasoning which emerges from the decisions of several High Courts adverted to earlier is that the mere fact that an assessee carries on business would not result in an inference that the income which is earned by way of interest would fall for classification as business income. Where an assessee invests its surplus funds in order to earn interest and to obviate its funds lying idle, such income would not fall for classification as business income. This is particularly so in a situation where the business of the assessee does not consist in the investment of funds. Where the assessee engages in an independent line of business, interest earned on deposits cannot be regarded as falling under the head of profits and gains of business or profession. Such income would fall for classification as income from other sources. In applying the provisions of s. 80HHC(1), the legislature has made a specific provision for the deduction of such profits of business as are derived from the export activity. The expression "derived from" has been construed to require a direct and proximate nexus with the business of export. Absent such a nexus, the income which results from the activity would have to be excluded from reckoning for the purposes of the formula prescribed by s. 80HHC.

36. In the present case, the contention of the assessee both before the AO and in appeal was that it carries on the business of the export of seeds, spices and similar goods. The funds required for the business were, according to the assessee, provided either by its directors/shareholders or borrowed from banks or private parties. The export bills of the assessee, against the fulfillment of export orders are sent for collection to banks and the assessee receives the discounted value of the sale proceeds. According to the assessee, the moneys which are so received are utilized for the repayment of its loans. If the assessee has no export orders and if there is still a balance, the assessee used its funds to discount the purchase bills of private parties for short periods of time of three to five weeks. For this activity, the assessee received interest of between 20 to 22 per cent. On the explanation of the assessee, which has been extracted in extenso in para 6 of the order passed by the AO, it is impossible for this Court to come to the conclusion that the interest which has been received by the assessee bears a direct and proximate relationship with the export activity. Evidently, the explanation of the assessee is sufficient to indicate that the funds which are utilized for discounting local sale bills of private parties are those which are surplus to the business. These surplus funds of the assessee are utilized for discounting bills on which the assessee received discounting charges. The same would hold true insofar as inter-corporate deposits are concerned. Income received by way of discounting charges and interest on inter-corporate deposits would not fall under the head of profits and gains of business or profession but would fall under the head of income from other sources. Having no direct and proximate nexus with the export activity such income has to be wholly kept out of the reckoning for computing the deduction u/s 80HHC.

(Emphasis, here printed in italics, supplied)

20. In the present case also, it is impossible for this Court to come to the conclusion that interest received by the assessee bears a direct and proximate relationship with their export activity. As in that case, in the present case also, the funds which were utilized were those which were surplus to the assessee's business. At the cost of repetition, in the present case also, the assessee's business does not consist in the investment of funds. The facts of this case do not persuade us to depart from the normal rule that where an assessee invests funds surplus to the business and earns interest, such interest does not constitute business income but falls under the head of "Income from other sources". Paragraph 27 of the judgment, in fact, militates against Mr. Pardiwalla's other submissions also.

21. In CIT v. Swani Spices Mills (P) Ltd. (*supra*) the Division Bench dealt with the judgment in CIT v. Lok Holdings (*supra*) in paras 25 and 26. It was held that the judgment was based on the peculiar facts and circumstances of that case and cannot be held to lay down a broad proposition of law that an investment of surplus funds by an assessee who carries on business must necessarily be construed to result in the generation of business income by way of interest received on investment. The Division Bench held:

25. In Commissioner of Income Tax Vs. Lok Holdings, , the assessee was engaged in construction business and had received moneys from purchasers of flats, which were deposited with a bank. The interest income on the money deposited with the bank was treated as income from other sources by the AO. The CIT(A) deleted the addition made by the AO and the Tribunal confirmed that decision. The Division Bench held that the income in that case admittedly arose out of a running business. The interest was earned out of the moneys which accrued from the business of the assessee and was utilized for the purpose of business. The judgment in Tuticorin was distinguished on the ground that in that case the assessee had not commenced business and it was in that context that the Supreme Court had held that a company which had not commenced business could not have business income. In the facts before the Court in Lok Holdings (*supra*), it was held that the assessee was engaged in construction business and earned interest on the money deposited in the course of business.

26. The judgment of the Division Bench in Lok Holdings (*supra*) is based on the peculiar facts and circumstances as they emerged before the Court in that case. The decision would indicate that the investments made by the assessee were not a mere investment of its surplus funds.

The investments made were regarded by the Division Bench as those which resulted in earning income from the running business of the assessee. The interest was utilized for the purpose of business and it was in these circumstances that the Division Bench must be construed to have found the existence of a direct and proximate nexus between the income that was earned

and the business activity of the assessee. So construed, the judgment of the Division Bench is confined to the facts as they emerged before the Court in that case. The judgment of the Division Bench in Lok Holdings (supra) cannot be held to lay down a broad proposition of law that an investment of surplus funds by an assessee who carries on business must necessarily be construed to result in the generation of business income by way of interest received on investment.

22. Mr. Pardiwallas third submission is also, therefore, rejected. The judgment of this Court in CIT v. Swani Spices Mills (P) Ltd. (supra), is, in fact, an answer to all three submissions.

23. Mr. Pardiwalla further submitted that by granting the benefit u/s 80HHC, even in part, the AO accepted that the assessee had complied with the provisions thereof including utilizing the amount credited to the reserve account for the purposes of the business of the assessee in accordance with the second proviso thereto. According to him, had the AO not accepted this case, he would have denied the assessee the entire benefit u/s 80HHC.

24. The submission cannot be accepted in view of what we have held. We will assume that if an assessee does not utilize the amount credited to a reserve account for the purpose of its business, the AO is bound to reject the entire claim for deduction made there under. If the view that we have taken is correct, the AO having granted the deduction in part, rightly or wrongly, cannot enure to the assessee's benefit. Thus, merely because the AO did not reopen the assessment u/s 147 read with section 148, the assessee would not be entitled to contend that they were entitled to the benefit of section 80HHC despite the conclusion of this Court that they are not entitled to the same.

25. In the circumstances, the question referred to this Court is answered in the affirmative, in favour of the Revenue and against the assessee. The reference is, accordingly, disposed of. There shall be no order as to costs.