(2007) 04 OHC CK 0024

In the Orissa High Court

Tata Sponge Iron Ltd. APPELLANT

Vs

Commissioner of Income Tax RESPONDENT

Date of Decision : 10-04-2007

Acts Referred:
COMPANIES ACT, 1956 — Section 3
Income Tax Act, 1961 — Section 256, 260A, 27, 28, 29

Citation : (2007) 292 ITR 175 : (2007) 1 OLR 865 Supp

Hon'ble Judges : I. Mahanty, J;B.P. Das, J

Bench : Division Bench

Final Decision : Allowed

Judgement

I. Mahanty, J.—M/s. Tata Sponge Iron Limited, the appellant, is a public limited company carrying on the business of manufacture and sale of sponge iron and incorporated under the Companies Act, 1956. The appellant has preferred this appeal u/s 260A of the Income Tax Act, 1961 (hereinafter referred to as "the Act") seeking to challenge the order dated October 13, 2003, passed by the Income Tax Appellate Tribunal in I.T.A. No. 83/CTK/2000 pertaining to the assessment year 1996-97.

2. This court vide the order dated May 3, 2006, was pleased to admit the appeal on the following two questions of law:

(I) Whether, on the facts and in the circumstances of the case, the learned Income Tax Appellate Tribunal is right in holding that the expenses incurred towards repairs, depreciation and salary paid to staff looking after the transit house indirectly is not allowable as deduction while computing the income from business solely because of the provision in Section 37(4A) of the Income Tax Act, 1961 ?

(II) Whether, on the facts and in the circumstances of the case, the learned Income Tax Appellate Tribunal is right in disallowing the relief u/s 80HH of the Act on the whole of interest receipts of Rs. 3,11,86,442 without setting off the interest payments of Rs. 2,35,38,917 ?

3. In so far as the first question of law is concerned, it is seen from the order of the Income Tax Appellate Tribunal that the same relates to the claim for deduction of expenditure made by the assessee towards salary and wages of guest house staff and depreciation of guest house and the claim for the same to be admissible under Sections 28 to 32 of the Income Tax Act. The assessee claims that the restriction provided for in the residuary Section 37 of the Act should not be applied to such expenses. The assessee also claims that Section 37(4) of the Act overrides the general provisions contained under Sections 27 to 32 of the Act and accordingly claims that guest house expenses, wages and salary as well as depreciation of the guest house are to be allowed.

4. The Tribunal has noted in the impugned order that in view of the judgment in the case of United Catalysts India Ltd. Vs. Commissioner of Income Tax, , the guest house expenses are not allowable and therefore, the Tribunal affirmed the addition of such expenditure into the income assessable of the assessee.

5. Shri S.N. Ratho, learned Counsel for the appellant submitted that this question is no longer res integra and has been settled against the assessee and in favour of the Revenue by the hon''ble Supreme Court in the case of Britannia Industries Ltd. Vs. Commissioner of Income Tax, West Bengal, Kolkata and Another, and in view of such determination, question No. 1 need not be answered. Shri Akhil Mohapatra, learned Counsel for the Revenue also affirms the same and accordingly, question No. 1 is decided against the assessee and in favour of the Revenue in the light of the judgment of the apex court referred to above.

6. In so far as the second question of law noted hereinabove is concerned, the same relates to a claim of deduction u/s 80HH of the Act. Shri Ratho, learned Counsel for the appellant submitted that the assessee earned interest from various sources noted hereinbelow:

Interest from

(Rs.)

1. Deposit with bank

54,88,403

2. Inter-corporate deposits

93,93,102

3. Customers

99,42,335

4. Bill discounting

63,62,602

3,11,86,442

7. Shri Ratho submitted that against the aforesaid earning of interest, it had also incurred expenses amounting to Rs. 2,35,38,917 as interest paid on borrowed funds. Therefore, he submits that in effect the earning from interest is Rs. 76,47,525 (Rs. 3,11,86,442 - Rs. 2,35,38,917). In this respect, Shri Ratho submitted that the interest earning ought to qualify for relief u/s 80HH of the Act, since such earning arose out of borrowed funds of the assessee, which were not immediately required for earning some interest and accordingly, he submitted that such interest earned under items Nos. 1, 2 and 4 ought to be classified as such.

8. In so far as interest earned from delayed payment by customers is concerned, i.e., item No. 3, Shri Ratho submitted that the same was earned by the assessee from customers who chose to delay in making payment for purchases, and since the assessee in this case was carrying on an ongoing business of "manufacture" during the previous year, the present case was a case where the assessee had earned income after its business had actually commenced. Therefore, Shri Ratho, reiterated that the assessee had no other business except the business of manufacture and sale of sponge iron and even though the Revenue had granted the appellant similar claims u/s 80HH for earlier years, rejecting the same for the assessment year 1996-97 is wholly erroneous in law.

9. Shri Ratho, further submitted that the Assessing Officer (the AO) did not allow the assessee relief u/s 80HH on the ground that the interest income of the assessee did not form part of the business carried on by the assessee, whereas in appeal, the Commissioner of Income Tax (Appeals) upheld the disallowance, although he treated interest income of the assessee as business income. Further, the Tribunal also disallowed the claim of the assessee by placing misplaced reliance on the judgment of the apex court in the case of Pandian Chemicals Ltd. Vs. Commissioner of Income Tax, .

10. Shri Ratho, submitted that the apex court while dealing with the case of Pandian Chemicals was concerned with interest earned on deposit with the electricity board and submitted that the said case would have no applicability to the present case, inasmuch as, the appellant in the present case, had not earned any interest from similar deposits with any electricity board. He reiterated that the interest earned on the deposit in Pandian Chemicals'' case was taken not to be a deposit made for the purpose of its business. He submitted that in the present case at hand, each of the four heads on which the present appellant earns interest, ought to be cumulatively accepted as an act of prudent management on the part of the assessee to utilize its resources for the best interest of the company. It is further submitted that interest from deposits in bank (item No. 1) was the interest earned by the assessee from bank deposit of funds not immediately required by the appellant-company and therefore, was an act of prudent financial management on the part of the assessee. Interest earned from delayed payment by the customers (item No. 3) was the interest paid by

the customers who delayed payment for sale proceeds. It is further submitted that the assessee did not do any additional voluntary act, unlike Pandian Chemicals'' case making deposits and that the sale of manufactured articles and collection of payment thereof is an inseparable part of the industrial activity of the present assessee. In this respect, Shri Ratho placed reliance on the judgment of the Madras High Court in the case of CIT v. Madras Motors Ltd. . He submitted that the aforesaid decision has already been followed by a later decision of the Madras High Court in the case of Commissioner of Income Tax Vs. Indo Matsushita Carbon Co. Ltd., .

11. Learned Counsel for the appellant also placed reliance on a judgment in the case of Nirma Industries Limited Vs. Deputy Commissioner of Income Tax, , the relevant portion of which is quoted hereinbelow:

The purchaser pays a higher sale price if it delays payment of the sale proceeds.... The distinction drawn by the Revenue is artificial in nature and is neither in consonance with law nor commercial practice.

The Tribunal has failed to appreciate that it is not the case of the Assessing Officer that the interest income is not assessable under the head ''Profits and gains of business''. It is only while computing relief that the Revenue changes its stand...therefore, on this limited count alone, the order of the Tribunal suffers from a basic fallacy resulting in an error in law and on facts.

12. Shri Ratho thereafter dealt with the three other heads under which interest has been earned by the assessee, i.e., interest from bank deposits, interest on intercorporate deposits and interest from bill discounting. It is submitted that the aforesaid three items of interest were earned by the assessee on account of prudent investment of idle funds voluntarily. As a consequence of such interest earning, the cost of production was reduced and consequently enhanced the profits of the assessee due to efficient and prudent financial management of the assessee''s manufacture business. It is further submitted that by denying the claim of deduction by the assessee, the assessee has in effect been penalized for conducting its business in a manner that subserved the mandatory direction of the law. In this respect, the appellant has placed reliance on a judgment of the apex court in the case of Commissioner of Income Tax (Central), Madras Vs. Canara Workshops (P) Ltd., Kodialball, Mangalore, wherein the apex court took note of the underlying object of the enactment of Section 80E of the Act in the following manner:

It is obvious from the object of the terms in which it provides relief that the intention of Parliament.... It is clear that the benefit was directed to the setting up and also the efficient working of the priority industries.

13. He has further placed reliance on the judgment of the apex court in the case of Commissioner of Income Tax, Bangalore Vs. J.H. Gotla, Yadagiri, wherein the apex court laid down the principles of interpretation of statutes in the following manner (page 339):

Where the plain literal interpretation of a statutory provision produces a manifestly unjust result which could never have been intended by the Legislature, the court might modify the language used by the Legislature so as to achieve the intention of the Legislature and produce a rational construction.

14. A further contention advanced by Mr. Ratho, was to the effect that the legislative intent behind the enactment of Section 80HH (introduced with effect from April 1, 1974) can also be inferred from a conscious omission to amend Section 80HH when the Legislature amended Section 80HHC by the Finance (No. 2) Act, 1991, by introducing the Explanation (baa) in Section 80HHC. By inserting Explanation (baa), the bulk of the relief on items enumerated therein (namely, interest, commission etc.) was withdrawn. Shri Ratho submitted that no similar amendment or the Explanation was provided by the Legislature into Section 80HH when it carried out amendment to Section 80HHC, which clearly indicates, that the Legislature while on the one hand sought to limit the benefits available to the assessee u/s 80HHC, on the other hand, by omission, the Legislature, in fact, reiterated the wider benefits which intended to vest in the assessee claiming benefits u/s 80HH. Shri Ratho, in essence submitted that Section 80HH and the legislative intent behind it must be given a wider amplitude and that the present assessee who claims relief u/s 80HH should be entertained and considered favourably.

15. In this respect, Shri Ratho placed reliance on a judgment of this Court in the case of Tata Sponge Iron Ltd. v. State of Orissa (OJC No. 2213 of 2001, disposed of on August 9, 2006) (unreported till date) wherein this Court while considering whether a time-limit can be read into the Industrial Policy Resolution, when it did not explicitly contain any time limit. After considering all the aspects of the issue as well as several decisions of the Supreme Court, came to hold as follows:

It is well-settled law that the duty of the judicature is to act upon the true intention of the Legislature. In other words, if a provision is open to more than one interpretation, the court has to choose that interpretation which represents the true intention of the Legislature.

16. In support of the above submission, Shri Ratho placed reliance on the case of P.R. Prabhakar Vs. Commissioner of Income Tax, Coimbatore, to the following effect (page 555):

It is also trite law that an exemption is to be granted unless it is expressly taken away.

17. The summary of the aforesaid contentions advanced on behalf of the appellant are noted hereinbelow:

(1) Section 80HH has been indicated as an "incentive provision".

(2) There is no doubt that the provision of Section 80HH is applicable to the instant case and the only dispute relates to quantum of income eligible for such relief.

(3) Interest income indicated in paragraph 5 above constitutes only 4 to 5 per cent. of the total income of the assessee and such interest income could not have been earned without the funds borrowed from the assessee for its manufacturing business.

(4) The assessee is a manufacturer and seller of "sponge iron".

(5) Despite the items of interest have already been assessed for earlier years as income from business.

(6) Exemption u/s 80HH continues and that too without any amendment similar to the amendment made to Section 80HHC.

18. Shri Ratho advanced an alternative argument without prejudice to the earlier contentions, that in the event of any of the heads of income of interest would fail to pass the test of eligibility u/s 80HH(1), in that event, he contended that the profit and loss account of the assessee shows that Rs. 2,35,38,017 has already been paid as interest on borrowed funds of the assessee whereas a sum of Rs. 2,12,44,107 has been earned from the three items under consideration. He further submitted that the said income earned and interest paid on borrowed capital, have been shown separately only to conform to the requirements of Schedule VI, Part II, Section 3(v) and Section 3(xi)(b) of the Companies Act, 1956, which mandates that "expenditure for interest" to be shown at expenditure side and the "interest income" to be shown on the income side of the profit and loss account. Shri Ratho submitted that two heads of income i.e. interest paid and interest earned have been shown separately otherwise the same would have been shown under the same heading of expenditure and would have been set off and the expenditure would have been set off against the income and the net balance would have been shown either in income or expenditure heading. He submitted that in the present case if the first contention fails, then since the assessee has paid interest on borrowed funds of Rs. 2,35,38,017 and has earned interest of Rs. 2,12,44,107, after setting off the interest expenditure from the interest income, the only net amount of interest, if any, may be denied exemption and not the total interest income earned. In this respect, Mr. Ratho placed reliance on a decision of the apex court in the case of Keshavji Ravji and Co. v. CIT : [1990]183ITR1(SC) to the following effect (page 15):

If, instead of the transaction being reflected in two separate or distinct accounts in the books of the partnership, they were in one account...partake of the same character.

19. Drawing an analogy from the aforesaid judgment, Shri Ratho submitted that both, the interest earned and interest paid partake of the same character, since they are only referable from the said borrowed funds utilized for the purpose of efficient conduct of the business of the assessee. At the conclusion, learned Counsel for the appellant submitted that the learned Income Tax Appellate Tribunal has misconceived the case of Pandian Chemicals (supra). Without taking note of the fact that the facts eminent in the case of the present appellant are

basically different and such distinction was ignored by the Income Tax Appellate Tribunal and the following factual distinctions have been ignored by the Income Tax Appellate Tribunal:

(i) None of the four items of interest earned in the present case relates to deposits with electricity board.

(ii) Interest on delayed payment received from the customers directly relates to the business of the assessee.

(iii) The other three heads of interest earned are due to the various acts on the part of the assessee to invest its surplus funds as a prudent financial manager to protect the companies financial interests.

20. Shri Akhil Mohapatra, learned standing counsel for the Revenue supported the decision and the conclusion arrived at by the Income Tax Appellate Tribunal in its judgment dated October 13, 2003, vide annexure 4 to the present appeal. Shri Mohapatra, placed strong reliance upon the judgment of the apex court in the case of Pandian Chemicals (supra) and submitted that the Tribunal has correctly applied the ratio of this judgment to the facts and circumstances of the present case thereby not requiring any interference by this Court in exercise of its appellate jurisdiction u/s 260A of the Income Tax Act, 1961. Shri Mohapatra submitted that Section 80HH of the Act grants deduction only in respect of the profit and gains "derived from" an industrial undertaking and stated that in the aforesaid judgment the apex court has clearly stated that the words "derived from" in Section 80HH of the Income Tax Act, 1961, must be understood as something which has immediate nexus with the assessee''s industrial undertaking. He further submitted that interest earned by the assessee under all the four heads of interest earned in the present case is a step removed from the business of industrial undertaking, its manufacture and sale of sponge iron. He accordingly submitted that deriving an income of interest on deposits made with banks and/or customers cannot be said to flow directly from the industrial undertaking of the assessee i.e., manufacture and sale of sponge iron. Accordingly, the interest income claimed by the assessee u/s 80HH of the Act has correctly been rejected and/or turned down by the Revenue as well as affirmed by the Income Tax Appellate Tribunal in the impugned order vide annexure-4.

21. To sum up, Mr. Mohapatra submitted that none of the four heads of interest income indicated by the appellant can be claimed for relief u/s 80HH since such income does not bear any "direct or immediate nexus" with the appellant''s industrial undertaking and as such, the income is from an activity of the appellant which is a step removed from the business of the industrial undertaking and that the earning of interest in the present case cannot be said to flow directly from the industrial undertaking of the assessee.

22. Shri Mohapatra, relying upon the judgment in the case of Pandian Chemicals stated that no legislative intent could be inferred from the amendment of Section 80HHC and the non-amendment to Section 80HH, since it is well-settled that the

rules of interpretation would come to play only if there is any doubt with regard to the express language used. Where the words are unequivocal, there is no scope for importing the rule of liberal interpretation, as submitted by the appellant. He, accordingly, submitted that the judgment of the apex court in the case of Pandian Chemicals fully substantiates and supports the conclusion arrived by the Income Tax Appellate Tribunal and for such reason, the said judgment of the Tribunal merits no interference and the answer to question No. 2, as framed by this Court in the present appeal should be answered in the negative against the assessee and in favour of the Revenue.

23. The essential stand of the Revenue before us was that the issues raised in the present appeal are covered by the judgment of the apex court in the case of Pandian Chemicals Ltd. Vs. Commissioner of Income Tax, . The question that was referred to the High Court u/s 256(1) of the Income Tax Act in Commissioner of Income Tax Vs. Pandian Chemicals Ltd., is quoted herein below (page 279):

Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that the interest on deposits with Tamil Nadu Electricity Board should be treated as income derived by the industrial undertaking for the purpose of Section 80HH ?

24. On a plain reading of the facts of the present appeal, it is clear that interest earned by the present assessee is not due to any deposit made with the electricity board. Despite this distinction of facts, it has to be determined as to whether interest earned by the present assessee from "banks and intercorporate deposits" (items Nos. 1 and 2) and interest earned by the assessee on account of delayed payment by the customers, (items Nos. 3 and 4) can be equated with interest on deposits with the electricity board.

25. In the case of Pandian Chemicals Ltd. Vs. Commissioner of Income Tax, , the apex court was dealing with Section 80HH(1) which is quoted herein below (page 503 of 233 ITR):

Where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking, or the business of a hotel, 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 from such profits and gains of an amount equal to twenty per cent. thereof.

26. The hon''ble Supreme Court considered Section 80HH of the Act which grants deduction in respect of the profits and gains "derived from" an industrial undertaking. The apex court also took note of the fact that the words "derived from" had a narrower connotation than the expression "attributable to". In this respect, a reference was made to a judgment in the case of Cambay Electric Supply Industrial Co. Ltd. Vs. The Commissioner of Income Tax, Gujarat-II, Ahmedabad, , the relevant portion is quoted hereinbelow (page 93):

In this connection, it may be pointed out that whenever the Legislature wanted to give a restricted meaning in the manner suggested by the learned Solicitor-General, it has used the expression ''derived from'', as, for instance, in Section 80J. In our view, since the expression of wider import, namely, ''attributable to'', has been used, the Legislature intended to cover receipts from sources other than the actual conduct of the business of generation and distribution of electricity.

27. The hon''ble Supreme Court also took note of the judgment of the Privy Council in the case of CIT v. Raja Bahadur Kamakhaya Narayan Singh [1948] 16 ITR 325 to the following effect (page 328):

The word ''derived'' is not a term of art. Its use in the definition indeed demands an enquiry into the genealogy of the product. But the enquiry should stop as soon as the effective source is discovered. In the genealogical tree of the interest land indeed appears in the second degree, but the immediate and effective source is rent, which has suffered the accident of non-payment. And rent is not land within the meaning of the definition.

28. As well as a judgment of the Constitution Bench of the apex court in the case of In the matter of the Estate of Saradambal Ammal and Others, wherein the apex court approved and reiterated the views of the Privy Council as quoted hereinabove. It is, therefore, now settled that the words "derived from" contained in Section 80HH of the Act must be understood as something which has a direct or immediate nexus with the appellant''s industrial undertaking.

29. Before proceeding any further in the matter, it is important for us to consider the nature of the present appellant''s industrial undertaking. It is the admitted case of both the parties that the assessee is in the business of manufacture and sale of sponge iron. We are of the view that only those incomes which have "direct or immediate nexus" with the manufacture and sale of sponge iron alone, would qualify to be covered u/s 80HH and not any other income. In this respect, it has to be accepted that the industrial undertaking of the assessee was not limited to manufacture of sponge iron, but it has also extended thereof to the sale of manufactured items. Therefore, we are of the view that any interest earned by the assessee which has direct or immediate nexus with either manufacture or sale of its product has to be accepted to be an income which qualified as an income u/s 80HH. As contended by learned Counsel for the appellant, we are of the view that interest earned by the assessee from its customers for delayed payment and for bill discounting, such interest income does bear a direct and immediate nexus with the industrial undertaking of the assessee and therefore, interest earned from the customers, for delayed payment and bill discounting, are held to be income "derived" from the petitioners industrial undertaking and therefore, entitled for relief u/s 80HH.

30. Applying the provisions and the ratio of the judgment in the case of Pandian Chemicals Ltd. (supra), we are of the view that interest earned by the assessee

from the deposits made in bank and inter-corporate deposits, though attributable to the business of the assessee, is a step removed from the assessee''s industrial undertaking and therefore, cannot be held to have been "derived from" the industrial undertaking in order to qualify for relief u/s 80HH. We are, therefore, of the view that the interest earned by the assessee from the deposits with banks or intercorporate deposits (items Nos. 1 and 2) do not qualify for relief u/s 80HH.

31. In so far as the plea raised by the appellant regarding interpretation of statute is concerned vis-a-vis inference to be drawn from the amendment to Section 80HHC and non-amendment of Section 80HH, we are in agreement with learned Counsel for the Revenue, since Section 80HH itself, is clear and unambiguous, no necessity exists for the court to infer or derive any legislative intent. In view of the fact that this very conclusion has been reached by the apex court in Pandian Chemicals Ltd., we are constrained to reject this contention raised by the appellant.

32. In so far as the alternative plea is concerned, we are in complete agreement with the contention of the appellant that the mere reflection of transactions in two separate or distinct accounts in the books of the company do not by itself qualify for distinctly different treatment and since both, i.e., the interest earned and interest paid partake of the same character, set off as claimed is permissible under law. In this respect, reliance is placed on the judgment of the apex court in the case of Keshavji Ravji and Co. v. CIT : [1990]183ITR1(SC) .

33. In view of the discussions made hereinabove, we answer the question framed herein in the following manner:

(i) The Income Tax Appellate Tribunal was correct in holding that the expenses incurred towards repair, depreciation and salary paid to the staff looking after the transit house indirectly is not allowable as deduction while computing the income from business solely because of the provision in Section 37(4A) of the Income Tax Act, 1961.

(ii) The Income Tax Appellate Tribunal erred in disallowing relief u/s 80HH of the Act in so far as interest received of Rs. 1,63,04,937 is concerned and the Tribunal also erred in disallowing "set off" of interest payment of Rs. 2,35,38,917 against interest income of Rs. 1,48,81,505.

34. The appeal is partly allowed in terms of the answers to the questions of law framed hereinabove.

B.P. Das, J.

35. I agree

