



IN THE HIGH COURT OF DELHI AT NEW DELHI

ITA No. 196 of 2007

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Decided On: 29th October, 2009

Commissioner of Income Tax ... Appellant
through: Mr. N.P. Sahini, Advocate.

VERSUS

M/s. Magnum International Trading Company (Pvt.) Ltd. ... Respondent
through: Mr. Kaanan Kapoor, Advocate.

CORAM :-

THE HON'BLE MR. JUSTICE A.K. SIKRI
THE HON'BLE MR. JUSTICE SIDDHARTH MRIDUL

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI, J. (ORAL)

For orders, see ITA No. 1141 of 2006.


 (A.K. SIKRI)
 JUDGE


 (SIDDHARTH MRIDUL)
 JUDGE

October 29, 2009.

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IN THE HIGH COURT OF DELHI AT NEW DELHI

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Decided On: 29th October, 2009

1) ITA No. 1141 of 2006

Commissioner of Income Tax . . . Appellant
through : Mr. N.P. Sahini, Advocate.

VERSUS

M/s. Magnum International Trading Company (Pvt.) Ltd.
 . . . Respondent
through: Mr. Kaanan Kapoor, Advocate.

2) ITA No. 1149 of 2006

Commissioner of Income Tax . . . Appellant
through : Mr. N.P. Sahini, Advocate.

VERSUS

M/s. Magnum International Trading Company (Pvt.) Ltd.
 . . . Respondent
through: Mr. Kaanan Kapoor, Advocate.

3) ITA No. 1150 of 2006

Commissioner of Income Tax . . . Appellant
through : Mr. N.P. Sahini, Advocate.

VERSUS

M/s. Magnum International Trading Company (Pvt.) Ltd.
 . . . Respondent
through: Mr. Kaanan Kapoor, Advocate.

4) ITA No. 1503 of 2006

Commissioner of Income Tax . . . Appellant
through : Mr. N.P. Sahini, Advocate.

VERSUS



5) ITA No. 1504 of 2006

Commissioner of Income Tax . . . Appellant
through : Mr. N.P. Sahini, Advocate.

VERSUS

M/s. Magnum International Trading Company (Pvt.) Ltd.
. . . Respondent
through: Mr. Kaanan Kapoor, Advocate.

6) ITA No. 1505 of 2006

Commissioner of Income Tax . . . Appellant
through : Mr. N.P. Sahini, Advocate.

VERSUS

M/s. Magnum International Trading Company (Pvt.) Ltd.
. . . Respondent
through: Mr. Kaanan Kapoor, Advocate.

7) ITA No. 1506 of 2006

Commissioner of Income Tax . . . Appellant
through : Mr. N.P. Sahini, Advocate.

VERSUS

M/s. Magnum International Trading Company (Pvt.) Ltd.
. . . Respondent
through: Mr. Kaanan Kapoor, Advocate.

8) ITA No. 1507 of 2006

Commissioner of Income Tax . . . Appellant
through : Mr. N.P. Sahini, Advocate.

VERSUS

M/s. Magnum International Trading Company (Pvt.) Ltd.
. . . Respondent
through: Mr. Kaanan Kapoor, Advocate.



VERSUS

M/s. Magnum International Trading Company (Pvt.) Ltd.

... Respondent

through: Mr. Kaanan Kapoor, Advocate.

10) ITA No. 1675 of 2006

Commissioner of Income Tax

... Appellant

through : Mr. N.P. Sahini, Advocate.

VERSUS

M/s. Magnum International Trading Company (Pvt.) Ltd.

... Respondent

through: Mr. Kaanan Kapoor, Advocate.

11) ITA No. 137 of 2007

Commissioner of Income Tax

... Appellant

through : Mr. N.P. Sahini, Advocate.

VERSUS

M/s. Magnum International Trading Company (Pvt.) Ltd.

... Respondent

through: Mr. Kaanan Kapoor, Advocate.

12) ITA No. 196 of 2007

Commissioner of Income Tax

... Appellant

through : Mr. N.P. Sahini, Advocate.

VERSUS

M/s. Magnum International Trading Company (Pvt.) Ltd.

... Respondent

through: Mr. Kaanan Kapoor, Advocate.

CORAM :-

THE HON'BLE MR. JUSTICE A.K. SIKRI

THE HON'BLE MR. JUSTICE SIDDHARTH MRIDUL



A.K. SIKRI, J. (ORAL)

1. Admit.
2. The following substantial questions of law arise for consideration in these appeals:
 - i) Whether the learned ITAT was correct in law in holding that amount of profit on sale of shares during the year was liable to be considered for the purpose of deduction under Section 80HHC of the Act?
 - ii) Whether the learned ITAT was justified in law in holding that the interest income earned by the assessee on account of surplus funds available was liable to be assessed as business income?
 - iii) Whether the Tribunal was correct in its interpretation of Section 80HHC and Section 80AB for the assessment year in issue for arriving at the conclusions in favour of the assessee.
3. The first question of law arises in ITA Nos.1141/2006, 1149/2006 and 1150/2006. The second and third questions arise in all these appeals.
4. Filing of paper book is dispensed with. With the consent of the learned counsel for the parties, we have heard the arguments and



5. As is clear from the aforesaid questions of law formulated all relate to interpretation of Section 80HHC of the Income Tax Act (hereinafter referred to as 'the Act'). Relevant portions of the provisions of Section 80HHC of the Act are reproduced below for better understanding:

"80HHC. Deduction 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 to the extent of profits, referred to in sub-section (1B), derived by the assessee from the export of such goods or merchandise...

xx xx xx

(baa) 'profits of the business' means the profits of the business as computed under the head 'Profits and gains of business or profession' as reduced by –

(1) ninety per cent of any sum referred to in clauses (iiia), (iiib), (iiic), (iiid) and (iiie) of section 28 or of any receipts by way of brokerage, commission, interest, rent; charges or any other receipt of a similar nature included in such profits, and

(2) the profits of any branch, office, warehouse or any other establishment of the assessee situate outside India;"

6. The Tribunal has included the amount of profit earned by the assessee on the sale of shares as well as the interest income earned by the assessee for the purpose of deduction under Section 80HHC of the Act. Insofar as the interest income is



the banks. It could not be treated as business income. In
aspect of the matter came up for consideration before this Court
in the case of *Commissioner of Income Tax etc. v. Shri Ram
Honda Power Equip etc.*, 289 ITR 475. Relevant discussions
in this behalf are as under:

"13. This Court was of the opinion that while ascertaining the true scope of the said provision, attention must necessarily be paid not only to the text, namely, the 'words' employed in that provision, but also the context. It was noted that the idea of Section 80HHC was to ensure that the exporter gets the benefit with reference to profits derived from exports. Having this objective of the provision in mind, the court proceeded to discuss as to whether surplus funds found with the bank and interest earned thereupon could be categorized as income from business or that would fall under the head '*Income from other sources*'. The opinion of the court was that where surplus funds are parked with the bank and interest is earned thereon it can only be categorized as income from other sources. This receipt merits separate treatment under Section 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 AO 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.

15. Explaining the import of clause (baa) of the explanation to Section 80HHC of the Act, it was observed by the Court that the said clause envisages a two step process in computing profits derived from exports. First, the AO is required to apply Sections 28 to 44 in order to compute the profits and gains of business or profession. In doing so, the AO may find that certain incomes, which have no nexus to the export business of the assessee, are



arrive at the profits derived from export. The expression "by way of" which qualified the word "income" in Section 80M is similar to the words "receipts by way of" occurring in Explanation (baa) of Section 80HHC of the Act. Further the words "included in such profits" occurs in both the provisions. Just as in *Distributors (Baroda) Pvt. Ltd. v. UOI*, (1985) 155 ITR 120 (SC) where it was explained by the Supreme Court that the words "such" profits can only be understood as "computed in accordance with the provisions of the Act", similar words in clause (baa) should partake of the same meaning. The underlying principle of netting appears to logically get attracted as no prudent businessman would allow taxation of the interest income de hors the expenditure incurred for earning such income. The words "included any such profits" following the words "receipts by way of interest", "commission", "brokerage", etc., is a clear pointer to the fact that only net interest would be includible in arriving at the business profit. Once business income has been determined by applying accounting standards as well as the provisions contained in the Act, the assessee would be permitted, in terms of Section 37 of the Act, to claim as deduction, expenditure laid out for the purposes of earning such business income. Support for this proposition is to be found from Circular No. 621 dated December 19, 1991 of the Central Board of Direct Taxes.

Explanation (baa) is relatable only to clause (a) of Section 80HHC(3) and not to clause (b) thereof. These operate in distinct areas and no inter-mixing is contemplated. Hence the word "interest" in clause (baa) to the Explanation in Section 80HHC is indicative of "net interest", i.e. gross interest less the expenditure incurred by the assessee in earning such interest.

18. At the same time, after discussing the matter at length in the aforesaid manner, the Court summarized its conclusions, at the end, in the following manner :-

"Conclusions

To summarise our conclusions:

(i) In computing what the profits derived from exports for the purposes of Section 80HHC(1) read with Section 80JJC(3) are, the nexus test has to be applied to exclude



'profits of the business', the AO has to undertake a two step exercise in the following sequence. He has to first 'compute' the profits of the business under the head "profits and gains of business or profession." In other words, he will have to compute business profits, in terms of the Act, by applying the provisions of Sections 28 to 44 thereof.

(iii) In arriving at profits of the business by the above method, the AO will exclude all such incomes which partake the character of 'income from other sources' which in any event are treated under Sections 56 and 57 of the Act and are therefore not to be reckoned for the purposes of Section 80HHC. The AO will apply the law as explained in the judgments of the Kerala High Court referred to above which have been affirmed by the Hon'ble Supreme Court.

(iv) Where surplus funds are parked with the bank and interest is earned thereon it can only be categorised as income from other sources. This Page 0528 receipt merits separate treatment under Section 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.

(v) Interest earned on fixed deposits for the purposes of availing 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 assessed 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 AO 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 80 HHC:

(a) 90% of any sum referred to in Clauses (iiia), (iiib)



receipt of a similar nature included in such profits;
and

(c) profits of any branch, office, warehouse or any other establishment of the assessed 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 AO 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 ITAT in Lalsons to this effect is affirmed. In holding as above, we differ from the judgments of the Punjab & Haryana High Court in Rani Paliwal and the Madras High Court in Chinnapandi and affirm the ruling of the Special Bench of the ITAT in Lalsons.

(ix) Where, as a result of the computation of profits and gains of business and profession, the AO 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 assessed for application of the netting principle.

19. It is, thus, clear that the Court was of the view that where surplus funds are parked with the bank and interest is earned thereon, it can only be categorized as '*income from other sources*'. Thus, it goes out of reckoning for the purpose of Section 80HHC. Even in a case where the exporter is required to mandatorily keep monies in fixed deposit, in order to avail credit facility for the export business, and interest earned on fixed deposits for the purpose of availing of credit facilities from the bank, it was held that that interest income has to be treated as *income from other sources* and not business income as it does not have an immediate nexus with the export business."

7. After detailed discussion, the Court held that interest income



business, interest from these surplus funds had no direct with the export. Therefore, that could not be included in the amount of income under the head of 'business income' for the purpose of deduction under Section 80HHC of the Act.

8. Mr. Kanan Kapoor, learned counsel appearing for the assessee was candid in admitting this legal position. Thus, the question of law No. (ii) is decided in the negative, *i.e.*, against the assessee and in favour of the Revenue.
9. Mr. Kapoor was, however, emphatic in his submission that on the facts of the present case, the amount of profit earned on sale of shares should be considered for the purpose of deduction under Section 80HHC of the Act. His submission in this behalf was that this issue relates to the Assessment Years 1989-90 and 1990-91 and therefore, to be considered on the basis of unamended provisions. He pointed out that the amendment to Section 80HHC was carried out by the Parliament vide Finance (No. 2) Act, 1991, which received the assent of the President on 27.09.1991 and therefore, the amendment to provisions became applicable from 1st April, 1992 and was prospective in nature. He referred to Circular No.621 issued by the Board of Direct Taxes, which clarified the provisions relating to exemption of the income from exports contained under Section 80HHC of the



"32.9 This amendment will take effect from the 1st day April, 1992 and will, accordingly apply, in relation to assessment year 1992-93 and subsequent years.

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32.10 The existing formula often gives a distorted figure of export profits when receipts like interest, commission, etc., which do not have an element of turnover are included in the profits and loss account.

32.11 It has, therefore, been clarified that "profits of the business" for the purpose of Section 80HHC will not include receipts by way of brokerage, commission, interest, rent, charges or any other receipt of a similar nature. As some expenditure might be incurred in earning these incomes, which in the generality of cases is part of common expenses, ad hoc 10 per cent deduction from such incomes is provided to account for these expenses."

10. His submission was that the AO had recorded a finding of fact that the income from profit on sale of shares was the business income. He thus submitted that even in *Shri Ram Honda Power Equip etc. (supra)*, this Court had categorically observed that if in a given case, the AO had held that the income is business income and that has not been challenged by the Department thereafter, then such a question cannot be permitted to be reopened.
11. We are unable to accept the submission of the learned counsel for the assessee. First of all, we may point out that the observations of this Court in *Shri Ram Honda Power Equip etc. (supra)* are in relation to the interest income, which were made in the context of netting of interest. That apart, it was



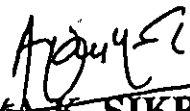
Section 80HHC of the Act, there was no occasion for Revenue to challenge the same. Occasion for Revenue to question the same thus arises in this appeal where this point is raised tersely though not very eloquently. Even otherwise on the material available on record, it is more than clear that such an income could not be treated as income from business. As per the assessee's own case before the AO, the assessee had earned profit on sale of shares amounting to Rs.11,55,953/-. It had itself proposed that this income be treated under the head 'income from capital gains'. It was also stated that it is not a line of business of the assessee to enter into sale and purchase of shares. The assessee had purchased shares of Best & Crompton over an extended period starting from March 1988 onwards with the motive of gaining the control over the said company. However, Vijay Mallya, controlling UB Group of Industries, Bangalore also got interested in that company and starting buying its shares. As per assessee's own explanation, considering the financial capacity of the UB Groups, it decided to sell those shares and earn profits.

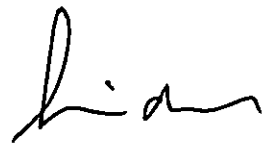
12. We are, therefore, of the opinion that such a transaction could not have got character of business activity and the income cannot be treated as business income. The ratio of *Shri Ram*



Profits are not from the export activity. Thus, Question is decided against the assessee and in favour of the Revenue. '✓'

13. Insofar as question No. 3 is concerned, it again stands decided in favour of the Revenue and against the assessee in view of detailed discussion above.
14. As a result of the aforesaid discussion, the judgment of the Tribunal is set aside and orders of the AO not to include amount of profit of sale on shares as well as amount of interest income for the purpose of deduction under Section 80HHC is restored.
15. Appeals are allowed in the aforesaid manner.


(A.R. SIKRI)
JUDGE


(SIDDHARTH MRIGUL)
JUDGE

October 29, 2009.

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