



\* **IN THE HIGH COURT OF DELHI AT NEW DELHI**  
**{ITA No. 106/2009}**

% Judgment delivered on: August 6,2010

**The Commissioner of Income Tax** **....Appellant**

Through Ms. Prem Lata Bansal, Advocate

Versus

**M/s Shahi Export House** **....Respondent**

Through Mr.M.P.Rastogi and Mr.Deepak K.  
Malik, Advocates

**CORAM:-**

**HON'BLE MR. JUSTICE A.K. SIKRI**  
**HON'BLE MS. JUSTICE REVA KHETRAPAL**

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)**

1. Admit.
2. The question which arises in this appeal is as under:-  

“Whether ITAT was correct in law in allowing benefit of netting of interest to the assessee while computing deduction u/s 80HHC of the Act?”
3. We have heard the final arguments with the consent of counsel for the parties.
4. It so happened that the assessee had earned interest on Rs.14,24,027/- on certain fixed deposit receipts. The question that



computing the benefit under Section 80HHC of the Income Tax Act and netting of the interest is to be allowed by deducting the same from the interest paid by the assessee on certain guarantees made by him from banks.

5. Both the parties agree that the matter is covered by the judgment of this court in Commissioner of Income Tax v. Shri Ram Honda Power Equip; 289 ITR 475. It is the application of the legal principle laid down in the said case, to the facts of this case, on which there is an issue between the parties.

6. In Shri Ram Honda Power Equip (Supra) after a detailed discussion on various aspects touching the interpretation of Section 80HHC of the Income Tax Act, the court summarized the conclusions in the following words:

“(i) In computing what the profits derived from exports for the purposes of section 80HHC(1) read with section 80HHC(3) are, the nexus test has to be applied to exclude that which does not partake of profits that can be said to have been derived from the business of exports.

(ii) In the specific context of clause (baa) of the Explanation to section 80HHC, while determining the “profits of the business”, the Assessing Officer 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 Assessing Officer will exclude all such incomes which partake of the character of “income from other sources” which in any event are treated under sections 56 and



The Assessing Officer 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 categorized as income from other sources. This receipt merits separate treatment under section 56 of the Act which is outside the ring of profits 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 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 situated 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



of the Income-tax Appellate Tribunal in *Lalsons* [2004] 8 ITR 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* [2004] 268 ITR 220 and the Madras High Court in *Chinnapandi* [2006] 282 ITR 389 and affirm the ruling of the Special Bench of the Income-tax Appellate Tribunal in *Lalsons* [2004] 8 ITR 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 that 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.”

7. A conjoint reading of conclusions No.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 concerned, the determinative test is as to whether such interest has “immediate nexus” with the export business.

9. In the present case, the interest is earned from certain fixed deposit receipts. These fixed deposit receipts were not, as a result of some surplus funds available to the assessee which was parked with the bank and the interest earned thereon. It has been found, as a fact, that the money was deposited in the bank and the fixed deposit receipt was taken by the assessee for the purposes of giving bank guarantees to enable the assessee to procure quota for export. Certain other fixed deposit receipts were of EEFC Account. Such receipts were deposited with the Apparel Export Promotion Council (AEPC) against guarantees being legal pre-condition for procurement of quota in the absence of which no business is done. It clearly implies that without such quota, which was ultimately procured by the assessee, no export of garment could be made. This quota is obtained from AEPC and AEPC sanctions the quota only when fixed deposit receipts are pledged with it in the form of a bank guarantee. It is because of the reason that the exporter is required to meet various conditions prescribed for allowing the quota. One of the conditions is to make actual exports to the extent of quota. If the exports are deficient then penalties can be imposed and to safeguard that, guarantees are obtained. Likewise, fixed deposit receipts on EEFC account also relate to the export.



10. It would, thus, be clear that furnishing of these fixed depo receipts is an obligation, and is a pre-condition for obtaining export quota in the absence of which exports cannot be made. In such a scenario, the furnishing of these bank guarantees is a direct nexus with the export activities of the assessee and interest earned thereupon would clearly be treated as having an immediate nexus with the export business.

11. We are, therefore, of the opinion that CIT appeal as well as Income Tax Appellate Tribunal has rightly applied the principle laid down in ***Shri Ram Honda Power Equip*** (Supra). It may be useful to mention that in ***Shri Ram Honda Power Equip*** (Supra) this court specifically affirmed the judgment of Special Bench of the Tribunal in ***Lal Sons Enterprises v. Commissioner of Income Tax; 2004 (89) ITD 25 (Delhi)*** and particularly the following observations which were extracted by this court as under:-

“if the interest received is found to have a nexus with the business, still it remains to be excluded from the profits of the business by virtue of Explanation (baa)(1), but the claim is that the quantum of such interest income to be excluded must be determined in accordance with the computation provisions relating to business by allowing expenditure by way of interest which bears a nexus with the interest receipt. The computation provisions included section 37(1) under which any expenditure incurred or laid wholly and exclusively for the purpose of the business is to be allowed as a deduction. Therefore, any expenditure incurred which has a connection or nexus with interest receipt has to be allowed as a deduction and only the balance can be excluded from the business profits.”



12. Once this positions is accepted, as per the formulation principle laid down in Shri Ram Honda Power Equip (supra) itself, netting has to be allowed by the adjustment of aforesaid interest received against the interest paid by the assessee to the bank on the credit facilities availed as is clear from the conclusion No.8 in the judgment.

13. We, accordingly, concur with the aforesaid view of the ITAT and thus answer the question in favour of the assessee and against the revenue, as a result this appeal is dismissed.

**(A.K. SIKRI)  
JUDGE**

**(REVA KHETRAPAL)  
JUDGE**

**AUGUST 06, 2010**

**SV**