* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **INCOME TAX APPEAL NO. 444/2011**

Reserved on : 8th May, 2012.

% **Date of Decision** : 18th July, 2012.

COMMISSIONER OF INCOME TAX .... Appellant

Through Mr. Kamal Sawhney, Sr. Standing Counsel & Mr. Amit Shrivastava, Advocate.

VERSUS

M/S KRIBHCO .....Respondent

Through Mr. S. Ganesh, Sr. Advocate with Ms. Surekha Raman & Mr. Anuj Sharma, Advocates.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE R.V. EASWAR

SANJIV KHANNA, J.:

Revenue by this appeal, which pertains to the Assessment Year 2006-07, impugns findings recorded by the Income Tax Appellate Tribunal (tribunal, for short) in their order dated 8th April, 2010 on the question of disallowance under Section 14A of the Income Tax Act, 1961 (Act, for short).

2. The respondent-assessee is a cooperative society and com within the administrative control of the Department of Fertilizers, Ministry of Agriculture and Co-operation, Government of India. The principal business of the assessee is manufacture of urea and ammonia. It is also engaged in marketing of fertilizers and purchase and processing of seeds. It earns interest income from banks, financial institutions, cooperatives etc. and earns service charges from Hazira Ammonia Extension Project etc.

3. For the assessment year in question, in the return filed on 30th October, 2006, the respondent-assessee had declared total income of Rs.2,82,50,91,480/-.

4. As per the return filed, the assessee had claimed deduction under Section 80P(2)(d) on dividend of Rs.2,00,006/- received from Nafed and Karnataka State Cooperative Apex Bank Limited and interest of Rs.10,20,75,013/- on deposits made with cooperative banks. The Assessing Officer did not disturb the said claim/deduction under Section 80P(2)(d) but relying upon Section 14A held that the aforesaid incomes were not included in the total income of the assessee and, therefore, expenditure under the head "interest" amounting to Rs.1,15,45,579 and 1/8 of the employee benefits and remuneration should be disallowed. He observed that the aforesaid expenditure had

been incurred for earning of income under Section 80P(2)(d) of the A and, therefore, has to be disallowed under Section 14A.

5. The assessee succeeded in the first appeal and before the tribunal. We may notice that in the first appeal, the assessee had raised several contentions on merits as to the quantum of disallowance of the expenditure under the head "interest" and had pointed out that the entire disallowance made of Rs.1,15,45,579/- was erroneous and contrary to law. The CIT(Appeals) has extensively quoted the aforesaid contention of the assessee but has not dwelled and answered the same as he had relied upon his earlier order.

6. By the order dated 1st September, 2011, the following two substantial questions of law were framed:

> "A. Whether the ITAT was correct in law in holding that no disallowance can be made against income which is not specifically exempt under the Act?
>
> B. Whether the ITAT was correct in distinguishing between deduction and exemption, which does not find any support in the language of Section 14A?"

7. We may only record that the appellant-Revenue had raised certain other aspects/questions, but these have not been framed in view of order passed in ITA No. 1406/2010 on the same date, i.e., 1st September, 2011.

8. In order to appreciate the controversy, we have to refer Section 2(45), Section 14A, Section 80A(1) & (2), Section 80AB and Section 80B(5), which for the sake of convenience are reproduced below in seriatim:

> *"**2. Definitions.--**In this Act, unless the context otherwise requires,*
>
> *(45) total income means the total amount of income referred to in section 5, computed in the manner laid down in this Act ;*
>
> *xxxx*
>
> ***14A. Expenditure incurred in relation to income not includible in total income.**—For the purposes of computing the total income under this Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act.*
>
> *Provided that nothing contained in this section shall empower the Assessing Officer either to reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154, for any assessment year beginning on or before the 1st day of April, 2001.*
>
> *xxxx*
>
> ***80-A. Deductions to be made in computing total income**.—(1) In computing the total income of an assessee, there shall be allowed from his gross total income, in accordance with and subject to the provisions of this Chapter, the deductions specified in Sections 80-C to 80-U.*
>
> *(2) The aggregate amount of the deductions under this Chapter shall not, in any case, exceed the gross total income of the assessee.*

> ***80-AB. Deductions to be made with reference to the income included in the gross total income****.—Where any deduction is required to be made or allowed under any section included in this Chapter under the heading "C. Deductions in respect of certain incomes" in respect of any income of the nature specified in that section which is included in the gross total income of the assessee, then, notwithstanding anything contained in that section, for the purpose of computing the deduction under that section, the amount of income of that nature as computed in accordance with the provisions of this Act (before making any deduction under this Chapter) shall alone be deemed to be the amount of income of that nature which is derived or received by the assessee and which is included in his gross total income.*
>
> *xxxx*
>
> ***80-B. Definitions****.—In this Chapter—*
>
> *(5) "gross total income" means the total income computed in accordance with the provisions of this Act, before making any deduction under this Chapter;"*

9. Section 2(45) defines the expression "total income" to mean the total amount of income referred to in Section 5 computed in the manner laid down under the Act. Section 4 of the Act states that income tax shall be charged for the assessment year in accordance with and subject to the provisions of this Act on the total income of the previous year of every person. Section 5 of the Act states that total income of a resident assessee includes all income and profits arising in

India and outside. We are not concerned with resident but not ordinarily resident and non-resident assessee in the present case.

10. Chapter III of the Act consists of Sections 10 to 13B and is with the heading "incomes which do not form part of total income". Thus, incomes falling under Sections 10 to 13B as per the heading itself shall not be included in computing the total income. We note that some of the said Sections only provide for partial exclusion and not complete exclusion of the income, i.e., income which does not form part of the total income. Chapter IV of the Act begins with Section 14 and states that save as otherwise provided by this Act all income for the purpose of charge of tax and computation of total income would be classified under the heads "salary", "income from house property", "profits and gains of business and professions", "capital gains" and "income from other sources". Then comes Section 14A, which we will be examining later on. Chapter IV consists of Sections 14 to 59 and deals with computation/quantification under separate heads of income mentioned in Section 14. Chapter V of the Act deals with income of other persons, which are to be included in the assessee's total income. Chapter VI, which begins with Section 66 and ends with Section 80, has various provisions relating to computation of income, set off and carry forwards of losses etc.

11. Chapter VIA heading reads "deductions to be made computing total income". Vide Sections 80A to 80U deductions to be made from the "gross total income" are stated.

12. The contention of the Revenue is that deductions, which are made under Chapter VIA, results in exclusion of the said income from the total income and, therefore, expenditure incurred for earning the said income has to be disallowed in view of the express provisions of Section 14A. It is submitted by the Revenue that the deduction when allowed under Chapter VIA results in exclusion of the said income from the total income, which is taxable. Therefore, in fairness the expenses incurred by the assessee to earn the said income should be excluded and not allowed. The contention of the assessee, on the other hand, is that Section 14A is not applicable as far as deductions, which are permissible and allowed under Chapter VIA are concerned. Section 14A is applicable only if an income is not included in the total income as per the provisions of Chapter III of the Act.

13. We find merit in the contention raised by the assessee. There are several reasons and grounds for the same apart from the placement of Section 14A in Chapter IV of the Act. Chapter VIA as noticed above does not consist of one section but there are numerous sections under which deductions are allowed. Some of the sections relate to

deductions in case of priority industries or industries/units set up in t specified area or export earnings etc. In these provisions/sections, it is not the gross income or entire receipt on which deduction is allowed. The deduction in several sections like Section 80I, 80HHC is allowed on the net amount of income, i.e., gross income less the expenditure incurred to earn the said income.

14. Section 80A(1) states that in computing total income an assessee will be allowed on the gross total income in accordance and subject to the provisions of the Chapter, deductions specified in Section 80C to 80U. The language of the section itself postulates and mandates that it is a deduction which is allowed from the gross total income. Thus, from the amounts included in the gross total income, deductions are to be allowed in respect of the incomes mentioned and specified in Sections 80C to 80U. In other words, the incomes specified in Sections 80C to 80U are chargeable to tax under Section 4 but have to be reduced/deducted as so stipulated and required by a particular section and on conditions stated therein being satisfied. Sub-section 2 to Section 80A states that the total amount of deduction shall not exceed the gross total income of an assessee. In other words, deduction cannot exceed the total income, i.e., the "gross total income" earned by the assessee in the year. The term "gross total income" has

been defined in Section 80B(5) to mean total income computed accordance with the provisions of this Act, before making any deduction under Chapter VIA. In other words, before computing the deduction under Chapter VIA, the requirement is that total income should be computed in accordance with the Act, but without making any deduction under the Chapter. It means that the income which qualifies for deduction under Chapter VIA has to be included in the gross total income. The income which is included has to be computed in accordance with the provisions of the Act, i.e., in accordance with Chapter IV, Chapter VI etc. As observed above, Section 80AB stipulates that while computing deduction under any Section in Chapter VIA, under the heading "C- Deductions in respect of certain incomes", we have to first compute amount of income of that nature in accordance with the provisions of the Act but without making any deduction under Chapter VIA. It is this income/receipt alone which qualifies and is taken into consideration for the purpose of deduction under Chapter VIA.

15. A reading of the aforesaid provisions elucidates that deduction, which are permissible and allowed under Chapter VIA, do not result in exclusion of the income from the charging section. Chapter VIA is different from the exclusions/exemptions granted/stated in Chapter III.

Incomes in Chapter III are not chargeable to tax and, therefore, f outside the ambit of Sections 4 and 5 of the Act. Such incomes do not form part of the total income and are, therefore, not subjected to tax. However, there are other income/receipts, which are subjected to and chargeable to tax but under specific provisions under Chapter VIA, an assessee is entitled to deductions. Thus, such incomes do form part of the income stated in Section 4 read with Section 5 but while computing the taxable income, deductions are allowed to the extent stipulated in Sections 80C to 80U of the Act. The distinction between the two, has been accepted and recognized by the Supreme Court in ***Second Income Tax Officer and Another versus Stumpp Schuele and Somappa Private Limited***, (1991) 187 ITR 108 (SC). It was held approving several decisions that the deductions under Chapter VIA cannot be equated with incomes not included in the total income or which are not chargeable to tax. Chapter VIA in several provisions makes reference to net income as computed in accordance with the provisions of the Act and not with reference to gross amount/entire receipt. For the purpose of computing the said deductions, profits/income is not computed as commercial profits but with reference to the provisions of the Act. In some cases, the qualifying units have to be treated as a separate entity for the purpose of

computing the deduction and thereafter the net income is compute Section 80AB begins with a non-obstante clause and has to be given full effect to. The decisions of High Courts proved by the Supreme Court in ***Stumpp Schuele and Somappa Private Limited*** (supra) and their ratios have been examined subsequently.

16. We have examined the five Judges decision of the Supreme Court in ***Distributors (Baroda) Private Limited versus Union of India and Others, (***1985) 155 ITR 120. In the said case, the Supreme Court was examining Section 80M after it was incorporated by Finance (No. 2) Act, 1967 and placed in the new Chapter VI-A, the heading of which, as noticed above, reads:-

"Deductions to be made in computing total income"

17. Section 80M, at the time of enactment, was as under:-

> *"80M. Deduction in respect of certain intercorporate dividends.-(1) Where the gross total income of an assessee being a company includes any income by way of dividends received by it from a domestic company, 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 income by way of dividends of an amount equal to*
>
> *(a) where the assessee is a foreign company (i) in respect of such income by way of dividends received by it from an Indian company which is not such a company as is referred to in*

section 108 and which is mainly engaged in a priority industry 80% of such income ;

(ii) in respect of such income by way of dividends other than the dividends referred to in sub-clause (i) 65% of such income :

(b) where the assessee is a domestic company-in respect of any such income by way of dividends 60% of such income."

18. It was noticed that the words "received by it" were omitted with effect from 1st April, 1968 by Finance Act, 1968. There were also subsequent amendments but reference to them is not relevant.

19. The Supreme Court referring to the language of the said Section observed that the words "include in income by way of dividend" may refer to the quality and category of income, i.e., dividend income and not quantum thereof but in the subsequent part of the said Section the words used were "such income by way of dividends". This reference was clearly not only to the character of income but also the quantum thereof. The aforesaid ratio was supported with reference to the quantification of the amount, i.e., 80%, 65% or 60% of such income. It was held that section in question did not refer to the gross total income, but the net total income and, therefore, clearly refers to the quantum of income and not the quality or character of income alone. Thus, the

deduction under Section 80M was on net dividend income and not the full or gross dividend. This is elucidate by the following observations of the Supreme Court in the said decision:

> *" Now, it was urged on behalf of the assessee that the words "where the gross total income of an assessee ... includes any income by way of dividends from a domestic company" in the opening part of sub-s. (1) of s. 80M refer only to the inclusion of the category of income and not to the quantum of such income and, therefore, the words " such income by way of dividends " following upon the specification of this condition, cannot have reference to the quantum of the income included but must be held referable only to the category of income included, that is income by way of dividends from a domestic company. This was the same argument which found favour with the court in Cloth Traders' case [1979] 118 ITR 243, but on fuller consideration, we do not think it is well founded. We may assume with the court in Cloth Traders' case [1979] 118 ITR 243, that the words " where the gross total income of an assessee ... includes any income by way of dividends from a domestic company " are intended only to provide that a particular category of income, namely, income by way of dividends from a domestic company should form a component part of gross total income, irrespective of what is the quantum of the income so included but it is difficult to see how the factor of quantum can altogether be excluded when we talk of any category of income included in the gross total income. What is included in the gross total income in such a case is a particular quantum of income belonging to the specified category. Therefore, the words "such income by way of dividends " must be referable not only to the category of income included in the gross total income but also to the quantum of the income so included. It is obvious, as a matter of plain grammar, that the words " such income by way of dividends " must have reference to the income by*

way of dividends mentioned earlier and that would be income by way of dividends from a domestic company which is included in the gross total income. Consequently, in order to determine what is " such income by way of dividends ", we have to ask the question : what is the income by way of dividends from a domestic company included in the gross total income and that would obviously be the income by way of dividends computed in accordance with the provisions of the Act. It is difficult to appreciate how, when we are interpreting the words " such income by way of dividends ", we can make a dichotomy between the category of income by way of dividends included in the gross total income and the quantum of the income by way of dividends so included. This court observed in Cloth Traders' case [1979] 118 ITR 243, that the words " such income by way of dividends " as a matter of plain grammar must be substituted by the words " income by way of dividends from a domestic company " in order to arrive at a proper construction of the section, but there is a clear fallacy in this observation, because in making the substitution, it stops short with the words " income by way of dividends from a domestic company " and does not go the full length to which plain grammar must dictate us to go, namely, " income by way of dividends from a domestic company included in the gross total income "(emphasis supplied) . Otherwise, we would not be giving to the word "such " its full meaning and effect. The word "such " in the context in which it occurs can only mean that income by way of dividends from a domestic company which is included in the gross total income and that must necessarily be income by way of dividends computed in accordance with the provisions of the Act.*

There is also one other strong indication in the language of sub-s. (1) of s. 80M which clearly compels us to take the view that the deduction envisaged by that provision is required to be made with reference to the income by way of dividends

computed in accordance with the provisions of the Act and not with reference to the full amount of dividend received by the assessee. This indication was also unfortunately lost sight of by the court in Cloth Traders' case [1979] 118 ITR 243, presumably because it was not brought to the attention of the court. The court observed in Cloth Traders' case [1979] 118 ITR 243, that the whole of the income by way of dividends from a domestic company or 60% of such income, as the case may be, would be deductible from the gross total income for arriving at the total income of the assessee. We are afraid this observation appears to have been made under some misapprehension, because what sub-s. (1) of s. 80M requires is that the deduction of the whole or a specified percentage must be made from " such income by way of dividends " and not from the gross total income. Sub-s. (1) of s. 80M provides that in computing the total income of the assessee, there shall be allowed a deduction from " such income by way of dividends " of an amount equal to the whole or a specified percentage of such income. Now, when in computing the total income of the assessee, a deduction has to be made from " such income by way of dividends ", it is elementary that It such income by way of dividends " from which deduction has to be made must be part of gross total income. It is difficult to see how the language of this part of sub-s. (1) of s. 80M can possibly fit in if " such income by way of dividends " were interpreted to mean the full amount of dividend received by the assessee. The full amount of dividend received by the assessee would not be included in the gross total income : what would be included would only be the amount of dividend as computed in accordance with the provisions of the Act. If that be so, it is difficult to appreciate how for the purpose of computing the total income from the gross total income, any deduction should be required to be made from the full amount of the dividend. The deduction required to be made for computing the total income from the gross total income can only be from the amount of dividend computed in accordance

with the provisions of the Act which would be forming part of the gross total income. It is, therefore, clear that whatever might have been the interpretation placed on clause (iv) of sub-s. (1) of s. 99 and s. 85A, the correctness of which is not in issue before us, so far as sub-s. (1) of s. 80M is concerned, the deduction required to be allowed under that provision is liable to be calculated with reference to the amount of dividend computed in accordance with the provisions of the Act and forming part of the gross total income and not with reference to the full amount of dividend received by the assessee.

This view which we are taking in regard to the construction of sub-s. (1) of s. 80M is also supported by the decision of a. Bench of this court consisting of one of us, Chandrachud C.J. and Tulzapurkar J., in Cambay Electric Supply Industrial Co. Ltd. v. CIT [1978] 113 ITR 84. This decision was rendered by the court on April 11, 1978, at least a year before the decision in Cloth Traders' case [1979] 118 ITR 243, but, unfortunately, it appears, it was not brought to the attention of the court when the Cloth Traders' case [1979] 118 ITR 243 was argued, because we have no doubt that if it had been cited, the court would have certainly made a reference to it in the judgment in Cloth Traders' case [1979] 118 ITR 243. The section which came up for consideration before the court in Cambay Electric Supply Co.'s case [1978] 113 ITR 84 was undoubtedly a different one, namely, s. 80E, but the reasoning which prevailed with the court in placing a particular interpretation on sub-s. (1) of s. 80E would equally be applicable to the interpretation of sub-s. (1) of s. 80M."

20. The penultimate paragraph of the above quote refers to Section 99 and 85A before they were substituted and it was clarified that the

Supreme Court had not examined the correctness of the interpretati given to the said Sections in earlier judgments of the High Courts or Supreme Court. This is important and relevant.

21. Section 99(1)(iv) of the Act, 1961 was as under:

> *"99. (1) Super-tax shall not be payable by an assessee in respect of the following amounts which are included in the total income...*
>
> *xxx*
>
> *(iv) if the assessee is a company, any dividend received by it from an Indian company, subject to the provisions contained in the Fifth Schedule."*

22. The said Section was interpreted by judgments of the High Courts of Bombay, Calcutta and Madras in ***CIT versus New Great Insurance Company Limited***, (1973) 90 ITR 348 (Bom.), ***CIT versus Darbhanga Marketing Company Limited***, (1971) 80 ITR 72 (Cal.) and ***CIT versus Madras Motor and General Insurance Company Limited***, (1975) 99 ITR 243 (Mad.) and ***Madras Auto Services Private Limited versus ITO***, (1975) 101 ITR 589 (Mad.). It was held that the gross amount of dividend received from an Indian company was excluded from super tax and the exemption was not limited or restricted to the net dividend income computed in accordance with the

provisions of the Act. The argument of the Revenue, that it is the r amount which is included in the total income, was rejected.

23. Reference was also made to an earlier Division Bench judgment of the High Court of Bombay in ***CIT versus Industrial Investment Trust Company Limited***, (1968) 67 ITR 436 (Bom.) with reference to notification dated 9th December, 1933 exempting from the super tax so much of income of any investment trust company as was derived from dividend paid by another company, which had paid or would pay super tax. The Supreme Court without expressing any firm opinion either in affirmative or negative observed that the High Court of Bombay had held that there was no warrant to construe the word "income" to mean dividend as computed under *Section 12* of the Act and the entire amount of dividend received would be exempt. The Bombay High noticed and had relied upon judgment of the Supreme Court in ***CIT versus South Indian Bank***, (1966) 59 ITR 763 (SC). In the said case, with reference to notification in question issued under Section 60A of the Income Tax Act, 1922 the Revenue had contended that the interest receivable on securities minus expenses incurred, and not the entire amount of interest, qualifies for deduction. This contention of the Revenue was rejected by the Supreme Court in the case of ***South Indian Bank*** (supra) giving the following reasons:

> *"It is common case that this notification applies to the securities in question. It will be noticed that this notification does not refer to the provisions of section 8 of the Income-tax Act at all. It gives a total exemption from income-tax to an assessee in respect of the interest receivable on income-tax free loans mentioned therein. It gives that exemption subject to two conditions, namely, (i) that the interest is received within the territories of the State of Travancore-Cochin, and (ii) that it is not brought into any other part of the taxable territories. It includes the said exempted interest in the total income of the assessee for the purpose of section 16 of the Incometax Act. Shortly stated, the notification is a self-contained one ; it provides an exemption from income-tax payable by an assessee on a particular class of income subject to specified conditions. Therefore, there is no scope for controlling the provisions of the notification with reference to section 8 of the Income-tax Act. The expression " interest receivable on income-tax free loans " is clear and unambiguous. Though the point of time from which the exemption works is when it is received within the territories of the State of Travancore-Cochin, what is exempted is the interest receivable. " Interest receivable " can only mean the amount of interest calculated as per the terms of the securities. It cannot obviously mean interest receivable minus the amount spent in receiving the same. We, therefore, hold agreeing with the High Court, that no income-tax is payable in respect of the entire interest of Rs. 44,720 earned by the assessee from securities issued by the former Native States."*

24. We may note that in the notification in question before the Supreme Court in ***South Indian Bank*** (supra), reference was only made to Section 16 of the applicable Act and not to Section 8 thereof.

25. ***Cambay Electric Supply Industrial Co. Ltd. vs. Commission , Income Tax, Gujarat-II,*** [1978] 113 ITR 84 (SC), was relied upon and quoted in ***Distributor Baroda's case*** (supra). In this case, the Supreme Court had interpreted Section 80E of the Act which at the relevant time was as under:-

> *"**80E. Deduction in respect of profits and gains from specified industries in the case of certain companies**.-(1) In the case of a company to which this section applies, where the total income (as computed in accordance with the other provisions of this Act) includes any profits and gains attributable to the business of generation or distribution of electricity or any other form of power or of construction, manufacture or production of any one or more of the articles or things specified in the list in the Fifth Schedule, there shall be allowed a deduction from such profits and gains of an amount equal to eight per cent. thereof, in computing the total income of the company.*
>
> *(2) This section applies to ---*
>
> *(a) an Indian company; or*
>
> *(b) any other company which has made the prescribed arrangements for the declaration and payment of dividends (including dividends on preference shares) within India,*
>
> *but does not apply to any Indian company referred to in clause (a), or to any other company referred to in clause (b), if such*

> *Indian or other company is a company referred to in section 108 and its total income as computed before applying the provisions of sub-section (1) does not exceed twenty-five thousand rupees."*

26. While dismissing assessee's appeal it was observed that unabsorbed depreciation and unabsorbed development rebate were deductable for computation of deduction under the said Section. It was elucidated that there were three steps which have to be taken by an Assessing Officer to compute the said deduction and these are:

(1) Determining profits and gains attributable to business of specified industry.

(2) As per parenthesis clause, the qualifying "income" has to be computed in accordance with all the provisions of the Act except Section 80E. Therefore, Sections 30 to 43A will apply. Accordingly, unabsorbed depreciation and unabsorbed development rebate had to be deducted.

(3) Lastly, computation of the deduction has to be made @ 8% on the profits and gains to arrive at the net total income, i.e. income computed as per the Act. It was observed that Section 72 appearing in Chapter VI would also apply as the provisions of the said Chapter have

direct impact on computation of income under the he "Profits and gains of business or profession".

The Supreme Court emphasized as under:-

> *"First, in sub-section (1) of section 80E, the expression "total income" is followed by the words "as computed in accordance with the other provisions of this Act" in parenthesis and the mandate of these words clearly negatives the argument that the expression "total income" has been used in the sense of commercial profits. Secondly, the expression "total income" has been defined in section 2(45) of the Act as meaning "the total amount of income referred to in section 5, computed in the manner laid down in this Act" and when this definition has been furnished by the Act itself the expression as appearing in section 80E(1) must, in the absence of anything in the context suggesting to the contrary, be construed in accordance with such definition. Since the words in the parenthesis occurring in sub-section (1) lay down the manner in which the total income of the concerned assessee is to be computed there would be no scope for excluding items like unabsorbed depreciation and unabsorbed development rebate while computing the total income on the basis that the total income spoken of by sub-section (1) means commercial profits."*

27. It was accordingly observed that on proper construction of Section 80E(1) full effect has to be give to the word 'such profits' and this was not possible without computing the income in accordance with the provisions of Sections 30 to 43A and then Chapter VI.

28. At this stage, we may refer to the decision of Delhi High Cou in ***CIT vs. Dalmia Cement (Bharat) Ltd.,*** (1980) 126 ITR 736, approved in ***Second ITO versus Stumpp, Schuele & Somappa Pvt. Ltd.*** (1991) 187 ITR 108 (SC)**.** In this case, the High Court was examining Rule 4 of Second Schedule to the Companies (Profits) Surtax Act, 1964 and whether deductions under Chapter VIA were part of income not included in the total income computed under the Act. The said Rule 4 was as under:-

> *"Where a part of the income, profits and gains of a company is not includible in its total income as computed under the Income-tax Act, its capital shall be the sum ascertained in accordance with rules 1, 2 and 3, diminished by an amount which bears to that sum the same proportion as the amount of the aforesaid income, profits and gains bears to the total amount of its income, profits and gains."*

29. The contention of the Revenue was that deductions once allowed under the said Section ceased to be part of profits included in the total income. This contention was rejected after recording the six substantive reasons given by the Karnataka High Court in ***Stumpp, Schuele & Somappa Pvt. Ltd. vs. Second ITO*** (1976) 102 ITR 320, upheld by Division Bench vide decision reported as ***Second ITO vs.***

Stumpp, Schuele & Somappa Pvt. Ltd. (1977) 106 ITR 399. The sa

six reasons recorded in ***Dalmia Cement (Bharat) Ltd.*** (supra) are:-

> *"(a) Any amount in respect of which deduction is claimed under any of the provisions in sections 80C to 80V is already included in the gross total income of the assessee and, therefore, cannot be stated to be not includible in the income of the assessee.*
>
> *(b) The expression " not includible " means not capable of being included. It cannot refer to an amount which already formed part of the total income. It refers to the classes of income, which Chap. III directs, " shall not be included " in the total income of the assessee.*
>
> *(c) The concept of deductions by way of expenses, rebates, allowances, etc., under Chaps. IV & VI-A is totally different from that of noninclusion.*
>
> *(d) Form No. 1 prescribed by r. 5, while giving instances of the items contemplated under r. 4, refers to agricultural income and foreign income of a non-resident which fall in Chap. III.*
>
> *(e) The history of the legislation showed that some of the items now included in Chap. VI-A were previously in Chap. VII (e.g., s. 80J corresponding to s. 84) and did not affect the capital computation for surtax purposes.*
>
> *(f) Logically, the argument of the revenue would mean that even deductions permitted under Chap. IV should be taken into account for r. 4 and the capital reduced correspondingly. This result is certainly not intended."*

30. While dealing with the detailed arguments raised by t Revenue, the Division Bench of this Court observed that broadly speaking the figure of total income is arrived at, as per the Act, in four stages. Firstly, the income of the resident assessee is computed by including all incomes, profits and gains arising in India or outside. Similarly income of resident but not ordinary resident or non-resident, are computed in accordance with Section 5 Chapter II, which forms the basis of Charge. Secondly, Chapter III with the heading "incomes not included in the total income", comprises of Section 10 to 13 and these incomes are not included in total income but some exemptions are only partial and not total. Thirdly, even in case of income, profit and gains included for arriving at the total income, the entire income is not liable to tax. Deductions as stipulated in Chapter IV can apply, e.g.. Sections 34, 35A and 35B etc. Even in Chapter VI, deductions for set off or carry forward of loss is allowed. Fourthly and lastly, certain deductions were permissible under Chapter VII and Chapter VIII and which had been substantial or partly replaced and were placed under Chapter VIA. These were deductions which were reduced from the income computed in accordance with the earlier provisions/Chapters of the Act. These deductions were made in the computation of total income and, therefore, definition of "gross total income", which was/is

arrived at without reference to the deduction allowable under Chapt VIA, was introduced. The deductions available under Chapter VIA were either wholly or partly reduced from the "gross total income". Contention of the Revenue that once deduction stands allowed, the "income" in view of the deduction ceases to be a part of the total income, was rejected by the Division Bench of this Court in ***Dalmia Cement (Bharat) Ltd.*** (supra), for the following additional reasons:-

(1) The word 'part' used in the Rule was to describe income fulfilling the description i.e. the category or class of the income. In other words it should indicate an identifiable section, category or class of income rather than mere portion or amount of such income. The question raised should be "whether this income was included" and not "whether any deduction was allowed". The use of the word 'part' contemplates a type of income which by its very nature does not form part of the total income. The word 'includible' supports that reference to the general nature and class of income rather than factual inclusion.

(2) It is not the actual quantification of the income which matters but whether or not income was excluded from the total income. It is the class of income rather than the amount

which would determine whether or not the said class income forms part of the total income. Incomes of the categories referred to in Chapter VIA were to be taken into account as a part of total income and they do form part of the gross total income which was the first step in the process. Accordingly, even after the deduction allowable under Chapter VIA, they form a part of the total income and do not get excluded merely because deduction is allowed.

(3) The Legislature had enacted Section 80C to 80U in Chapter VIA, as a measure of relief from taxable liability. It incorporates and allowes deductions. The income from these "sources" was included in the income, but subjected to deduction. Qualification would vary from Section to Section. Further in some cases the deduction was full and in some cases it was partial but this was not material and it did not mean that if an amount was deducted it did not form part of the total income.

Thus, the income on which the deduction is allowed forms a part of the total income, though not included in the amount or quantum on which tax is paid.

31. It can be urged (though it was not specifically argued by the Revenue) that in case of complete or entire deduction of the gross amount, Section 14A will be applicable, and Section 14A will not apply in case only the net amount (as stipulated in several Sections in Chapter VIA of the Act) is allowable as a deduction. There will be a fallacy in this argument. Even were partial or net amount is to be allowed as a deduction, the figure can be minus or in a loss. Logically, as a squiter, it will follow that in case the assessee has a negative/minus figure as per the computation made any of the provisions of Chapter VIA, the expenditure incurred cannot allowable under Section 37 of the Act, in view of Section 14A. The said position cannot be accepted. Income will include negative income or a loss. The corollary is that the entire income is included under the provisions of the Act by firstly including the entire receipts or incomes as stipulated in the charging section but after excluding the income stipulated in Chapter III. Thereafter, total income is computed under the Act by applying provisions of Chapter IV, V and VI. From this income, deductions are permitted and allowed in terms of Chapter VIA. Deductions do not mean that deduction allowed has the effect that the income, on which deduction is allowed, ceases to be part of the

total income. This is not the scheme, effect and purport of the Act. T expression "income which does not form part of the total income" refers to the nature, character or type of income and not the quantum.

32. Section 14A states that for the purpose of computing total income under Chapter IV, no deduction shall be allowed in respect of expenditure incurred in relation to the income which does not form part of the total income under this Act. It does not state that income which is entitled to deduction under Chapter VIA has to be excluded for the purpose of the said Section. The words "do not form part of the total income under this Act" is significant and important. As noticed above, before allowing deduction under Chapter VIA we have to compute the income and include the same in the total income. In this manner, the income which qualifies for deductions under Sections 80C to 80U has to be first included in the total income of the assessee. It, therefore, becomes part of the income, which is subjected to tax. Thereafter, deduction is to be allowed in accordance with and subject to the fulfillment of the conditions of the respective provisions. This is also subject to Section 80AB and 80A(1) and (2). Chapter VIA does not postulate or state that the incomes which qualify for the said deduction will be excluded and not form part of the total income. They form part of the total income but are allowed as a deduction and reduced.

33. It is clear from the aforesaid reasoning that the decisions in t case of ***Distributors (Baroda) Private Limited*** and ***Cambay Electric Supply Industrial Co. Ltd*** (supra) have proceeded on the specific language of the said Sections, whereas in the other decisions ***Stumpp Schuele and Somappa Private Limited*** and ***South Indian Bank*** (supra) and those of the High Courts mentioned above have gone on the general principle relating to deductions allowed and whether a deduction once allowed has the effect that the income on which deduction ceases to be part of the total income. It has been uniformly and consistently held that in the absence of express language to the contrary, deduction if allowed does not mean that the said income ceases to be part of the total income.

34. In view of the aforesaid position, we answer the questions of law mentioned above in affirmative, i.e., against the appellant-Revenue and in favour of the respondent-assessee. In the facts of the present case, there will be no order as to costs.

(SANJIV KHANNA)
JUDGE

(R.V. EASWAR)
JUDGE

JULY 18th, 2012
VKR