



IN THE HIGH COURT OF DELHI AT NEW DELHI

SUBJECT : INCOME TAX MATTER

Date of Reserve : November 29, 2006

Date of decision : January 12, 2007

ITA 166/2000 with

ITA.Nos. 29/2004, 39/2004, 56/2004

COMMISSIONER OF INCOME TAX DELHI Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr.Vishnu
Sharma, Advocate.

versus

SHRI RAM HONDA POWER EQUIP Respondent
Through Mr. Saubhagya Aggarwal with
Mr. A.K. Dash, Adv.

ITA 78/2002

COMMR.OF INCOME TAX Appellant
Through Mr. J.R. Goel, Adv.

versus

DAMANJIT SINGH Respondent
Through Mr. Salil Aggarwal, Adv.

ITA 62/2004

COMMISSIONER OF INCOME TAX-V N Appellant
Through Mr. R.D. Jolly, Sr. Standing
Counsel with Mr.Vishnu Sharma,
Advocate.



versus

NEE TEE CLOTHING P.LTD. Respondent
Through Dr. Rakesh Gupta with Mr.
Jitender Saini, Advs.

ITA 300/2004

J.R.SHRAMA OVERSEAS LTD. Appellant
Through Mr.Ajay Vohra with Ms. Kavita
Jha, Advocates.

versus

THE COMMISSIONER OF INCOME TAX Respondent
Through Mr. R.D. Jolly, Sr. Standing
Counsel with Mr.Vishnu Sharma,
Advocate.

ITA 461/2004

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr.Vishnu
Sharma, Advocate.

versus

ALANKAR EXPORTS Respondent
Through None

ITA 550/2004

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr.Vishnu
Sharma, Advocate.

versus



DETAILS PROP.TARA KOCHHAR Respondent
Through Dr.Rakesh Gupta with Mr.
Jitender Saini, Advocates.

ITA 596/2004

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr.Vishnu
Sharma, Advocate.

versus

ANAND KUMAR Respondent
Through Mr. G.K. Shukla, Adv.

ITA 648/2004

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr.Vishnu
Sharma, Advocate.

versus

TARUN CREATIONS P. LTD. Respondent
Through None

ITA 774/2004

COMMISSIONER OF INCOME TAX Appellant
Through Mr. Sanjiv Sabharwal, Adv. with
Mr.Vishnu Sharma, Advocate.

versus

RAHUL MERCHANDISING LTD. Respondent
Through None

ITA 144/2005



COMMISSIONER OF INCOME TAX DEL Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr.Vishnu
Sharma, Advocate.

versus

RAHUL MERCHANDISING LTD. Respondent
Through None

ITA 779/2004

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr.Vishnu
Sharma, Advocate.

versus

MAC EXPORTS (INDIA) Respondent
Through Mr. S.K. Khurana, Adv.

ITA 783/2004

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr.Vishnu
Sharma, Advocate.

versus

KRISHAN KUMAR AGGARWAL Respondent
Through None

ITA 2/2005

THE COMMISSIONER OF INCOME TAX Appellant
Through Mr.R.D.Jolly, Sr.Standing
Counsel with Mr.Vishnu Sharma,



Advocate.

versus

M/S LALSONS ENTERPRISES Respondent
Through Mr.Ajay Vohra, Advocate.

ITA 235/2005

THE COMMISSIONER OF INCOME TAX Appellant
Through Mr.R.D.Jolly, Sr.Standing
Counsel with Mr.Vishnu Sharma,
Advocate.

versus

M/S LALSONS ENTERPRISES Respondent
Through Mr.Ajay Vohra, Advocate.

ITA 101/2005

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal, Adv. with
Mr.Vishnu Sharma, Advocate.

versus

EASTERN EXPORTS Respondent
Through None

ITA 141/2005

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr.Vishnu
Sharma, Advocate.

versus

PAUSHAK Respondent



Through None

ITA 188/2005

COMMISSIONER OF INCOME TAX DEL Appellant
Through Ms. Prem Lata Bansal, Adv. with
Mr. Vishnu Sharma, Advocate.

versus

SHIVNATH RAI NARAIN (I) CO Respondent
Through None

ITA 430/2005

THE COMMISSIONER OF INCOME TAX Appellant
Through Mr. Sanjeev Sabharwal, Adv.
with Mr. Vishnu Sharma, Advocate.

versus

LATE SHRI R.S. BATRA Respondent
Through Mr. Satyen Sethi, Adv.

ITA 441/2005

COMMISSIONER OF INCOME TAX DEL Appellant
Through Mr. J.R. Goel, Adv.

versus

BENARAS HOUSE LTD. Respondent
Through Mr. R.S. Suri with Mr. Ajay
Dhalya & Mr. Gurvinder Suri, Adv.
Ms. Veronica Mohan, Advocate.

ITA 583/2005

COMMISSIONER OF INCOME TAX Appellant
Through Mr. J.R. Goel, Adv.



versus

BANARAS HOUSE LTD. Respondent
Through Mr. R.S. Suri with Mr. Ajay
Dhalya & Mr. Gurvinder Suri, Adv.
Ms. Veronica Mohan, Advocate.

ITA 523/2005

COMMISSIONER OF INCOME TAX Appellant
Through Mr. J.R. Goel, Adv.

versus

S.K. TRADING CORPORATION Respondent
Through None

ITA 841/2005

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr. Vishnu
Sharma, Advocate.

versus

C.L. CHAUDHARI Respondent
Through None

ITA 681/2005

COMMISSIONER OF INCOME TAX DEL Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr. Vishnu
Sharma, Advocate.

versus

DOON VALLEY RICE LTD. Respondent



Through None

ITA 924/2005

CIT Appellant
Through Ms. P.L. Bansal, Advocate with
Mr. Vishnu Sharma, Advocate.

versus

INDIAN HANDICRAFTS Respondent
Through None.

ITA 1016/2005

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr. Vishnu
Sharma, Advocate.

versus

SUNDER JHUREMALANI Respondent
Through None

ITA 85/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr. Vishnu
Sharma, Advocate.

versus

HONDA SIEL POWER PRODUCTS Respondent
Through Mr. Saubhagya Aggarwal with
Mr. A.K. Dash, Advs.

ITA 88/2006



COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr. Vishnu
Sharma, Advocate.

versus

NEELAM KOCHHAR Respondent
Through None

ITA 89/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr. Vishnu
Sharma, Advocate.

versus

HARISH KOCHHAR Respondent
Through None

ITA 147/2006

COMMISSIONER OF INCOME TAX DEL Appellant
Through Mr. R.D. Jolly, Sr. Standing Counsel
with Mr. Vishnu Sharma, Advocate.

versus

TARUN CREATIONS P. LTD. Respondent
Through None

ITA 234/2006

COMMISSIONER OF INCOME TAX DEL Appellant
Through Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Vishnu Sharma,
Advocate.



versus

KAJARIA CERAMICS LTD. Respondent
Through Mr.C.S.Aggarwal, Senior Advocate with
Mr. Prakash Kumar, Advocate

ITA 340/2006

COMMISISONER OF INCOME TAX DEL Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr.Vishnu
Sharma, Advocate.

versus

GURCHARAN KAUR Respondent
Through None

ITA 435/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms.Prem Lata Bansal, Sr.
Standing Counsel with Mr.Vishnu
Sharma, Advocate.

versus

H.P.LABS LTD. Respondent
Through Mr.Badri Nath, Advocate with
Mr. Rajesh Bhardwaj, Advocate

ITA 508/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr.Vishnu
Sharma, Advocate.

versus



PRADEEP KUMAR SAHNI Respondent
Through None

ITA 518/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr. Vishnu
Sharma, Advocate.

versus

PUNJAB STAINLESS STEEL INDUSTR Respondent
Through Mr. Satyen Sethi, Adv.

ITA 520/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr. Vishnu
Sharma, Advocate.

versus

PUNJAB STAINLESS STEEL INDUSTR Respondent
Through Mr. Satyen Sethi, Adv.

ITA 521/2006

COMMISSIONER OF INCOME TAX DEL Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr. Vishnu
Sharma, Advocate.

versus

EXOTIQUE EXPORTS Respondent
Through None

ITA 541/2006



COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr. Vishnu
Sharma, Advocate.

versus

BHARAT RASAYAN LTD. Respondent
Through Mr. Ajay Vohra with Ms. Kavita
Jha, Advocates.

ITA 545/2006

COMMISSIONER OF INCOME TAX DEL Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr. Vishnu
Sharma, Advocate.

versus

BHARAT RASAYAN LTD. Respondent
Through Mr. Ajay Vohra with Ms. Kavita
Jha, Advocates.

ITA 554/2006

COMMISSIONER OF INCOME TAX DEL Appellant
Through Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Vishnu Sharma,
Advocate.

versus

KAJARIA CEREMICS LTD. Respondent
Through Mr. C.S. Aggarwal, Sr. Adv. with
Mr. Prakash Kumar, Adv.

ITA 592/2006

COMMISSIONER OF INCOME TAX DEL Appellant



Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr.Vishnu
Sharma, Advocate.

versus

GURCHARAN KAUR Respondent
Through None

ITA 665/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. P.L. Bansal, Advocate with
Mr.Vishnu Sharma, Advocate.

versus

SANJIV PURI Respondent
Through Mr.K.R.Mahjani, Advocate.

ITA 666/2006

C.I.T Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr.Vishnu
Sharma, Advocate.

versus

EXOTIQUE EXPORTS Respondent
Through None

ITA 668/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. P.L. Bansal, Advocate
with Mr.Vishnu Sharma, Advocate.

versus



SANJIV PURI Respondent
Through Mr.K.R.Mahjani, Advocate.

ITA 756/2006

C.I.T Appellant
Through Ms. P.L. Bansal, Advocate with
Mr.Vishnu Sharma, Advocate.
versus

JYOTI APPARELS Respondent
Through Dr.S.Narayanan with
Ms.Meera Bhatia and Ms. Aakansha
Sharma, Advocates

ITA 768/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr.Vishnu
Sharma, Advocate.
versus

ANAND INTERNATIONAL Respondent
Through Mr.C.S.Aggarwal, Senior Advocate with
Mr. Prakash Kumar, Advocate

ITA 802/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr.Vishnu
Sharma, Advocate.

versus

RAM KISHAN Respondent
Through None



ITA 904/2006

COMMISSIONER OF INCOME TAX DEL Appellant
Through Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Vishnu Sharma,
Advocate.

versus

MOKUL OVERSEAS LTD. Respondent
Through Dr. Rakesh Gupta with Mr.
Jitender Saini, Advocates.

ITA 928/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr. Vishnu
Sharma, Advocate.

versus

KRAFT LAND INDIA Respondent
Through Mr. V.K. Sabharwal, Adv.

ITA 1092/2006

COMMISSIONER OF INCOME TAX DEL Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr. Vishnu
Sharma, Advocate.

versus

GNB BROS. P.LTD. Respondent
Through Dr. Rakesh Gupta with Mr.
Jitender Saini, Adv.

ITA 1300/2006



ATUL ANAND Appellant
Through Ms. Shashi M. Kapila, Advocate.

versus

D.C.I.T. CIRCLE 15 (I) Respondent
Through Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Vishnu Sharma,
Advocate.

ITA 1301/2006

ATUL ANAND Appellant
Through Ms. Shashi M. Kapila, Advocate.

versus

D.C.I.T. CIRCE 15 (I) Respondent
Through Mr. R.D. Jolly, Sr. Standing
Counsel with Mr. Vishnu Sharma,
Advocate.

ITA 1460/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr. Vishnu
Sharma, Advocate.

versus

PUNJAB STAINLESS STEEL IND Respondent
Through Mr. Satyen Sethi, Adv.

ITA 1494/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr. Vishnu



Sharma, Advocate.

versus

PUNJAB STAINLESS STEEL IND Respondent
Through Mr. Satyen Sethi, Adv.

ITA 1599/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. P.L. Bansal, Advocate with
Mr. Vishnu Sharma, Advocate.

versus

JYOTI APPARELS Respondent
Through Dr.S.Narayanan with
Ms.Meera Bhatia and Ms. Aakansha
Sharma, Advocates

ITA 1618/2006

COMMISSIONER OF INCOME TAX Appellant
Through Ms. Prem Lata Bansal, Sr.
Standing Counsel with Mr. Vishnu
Sharma, Advocate.

versus

ANAND KUMAR Respondent
Through None.

CORAM :-

HON'BLE MR. JUSTICE VIKRAMAJIT SEN
HON'BLE DR. JUSTICE S. MURALIDHAR

JUDGMENT

Dr. S. Muralidhar, J.



1. These appeals involve substantial questions of law concerning interpretation of Section 80HHC of the Income Tax Act, 1961 ('Act'), and in particular sub-section (1) read with sub-section (3) and clause (baa) of the Explanation below sub-section (4C) thereto.

2. Section 80HHC was first inserted by the Finance Act 1983 with effect from 1.4.1983 and has since undergone several changes. The portions of the provision, as presently found in the Act, relevant to the present batch of cases, read as under:

“Deduction in respect of profits retained for export business.

80HHC. (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:

(1B) For the purposes of sub-sections (1) and (1A), the extent of deduction of the profits shall be an amount equal to—

(i) eighty per cent thereof for an assessment year beginning on the 1st day of April, 2001;

(ii) seventy per cent thereof for an assessment year beginning on the 1st day of April, 2002;

(iii) fifty per cent thereof for an assessment year beginning on the 1st day of April, 2003;

(iv) thirty per cent thereof for an assessment year beginning on the 1st day of April, 2004,

and no deduction shall be allowed in respect of the assessment year beginning on the 1st day of April, 2005 and any subsequent assessment year.

.....

(3) For the purposes of sub-section (1), —

(a) where the export out of India is of goods or merchandise manufactured [or processed] by the assessee, the profits derived from such export shall be the amount which bears to the profits of the business, the same proportion as the export turnover in respect of such goods bears to the total turnover of the business carried on by the assessee ;

(b) where the export out of India is of trading goods, the profits derived from such export shall be the export turnover in respect of such trading goods as reduced by the direct costs and indirect costs attributable to such export ;



(c) where the export out of India is of goods or merchandise manufactured or processed by the assessee and of trading goods, the profits derived from such export shall,—

(i) in respect of the goods or merchandise manufactured or processed by the assessee, be the amount which bears to the adjusted profits of the business, the same proportion as the adjusted export turnover in respect of such goods bears to the adjusted total turnover of the business carried on by the assessee ; and

(ii) in respect of trading goods, be the export turnover in respect of such trading goods as reduced by the direct and indirect costs attributable to export of such trading goods :

Provided that the profits computed under clause (a) or clause (b) or clause (c) of this sub-section shall be further increased by the amount which bears to ninety per cent of any sum referred to in clause (iiia) (not being profits on sale of a licence acquired from any other person), and clauses (iiib) and (iiic) of section 28, the same proportion as the export turnover bears to the total turnover of the business carried on by the assessee :

(4) The deduction under sub-section (1) shall not be admissible unless the assessee furnishes in the prescribed form, along with the return of income, the report of an accountant, as defined in the Explanation below sub-section (2) of section 288, certifying that the deduction has been correctly claimed in accordance with the provisions of this section:

.....

(4B) For the purposes of computing the total income under sub-section (1) or sub-section (1A), any income not charged to tax under this Act shall be excluded.

Explanation.—For the purposes of this section,—

(a) “convertible foreign exchange” means foreign exchange which is for the time being treated by the Reserve Bank of India as convertible foreign exchange for the purposes of the Foreign Exchange Regulation Act, 1973 (46 of 1973), and any rules made thereunder ;

(aa) “export out of India” shall not include any transaction by way of sale or otherwise, in a shop, emporium or any other establishment situate in India, not involving clearance at any customs station as defined in the Customs Act, 1962 (52 of 1962);

(b) “export turnover” means the sale proceeds, received in, or brought into, India by the assessee in convertible foreign exchange in accordance with clause (a) of sub-section (2) of any goods or merchandise to which this section applies and which are exported out of India, but does not include freight or insurance attributable to the transport of the goods or merchandise beyond the customs station as defined in the Customs Act, 1962 (52 of 1962);



(ba) “total turnover” shall not include freight or insurance attributable transport of the goods or merchandise beyond the customs station as defined in the Customs Act, 1962 (52 of 1962) :

Provided that in relation to any assessment year commencing on or after the 1st day of April, 1991, the expression “total turnover” shall have effect as if it also excluded any sum referred to in clauses (iiia), (iiib), (iiic), (iiid) and (iiie) of section 28;

(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 ;

(emphasis supplied)

Analysis of Section 80HHC

3. The background to the introduction of Section 80HHC with effect from 1.4.1983, has been adverted to in paragraph 42.1 of the CBDT Circular No. 372 dated 8.12.1983 in the following words: “With a view to encouraging a larger export of goods, the Finance Act, 1982 had inserted Section 89A in the Income Tax Act with effect from 1.6.1982 for providing tax relief to Indian companies and non-corporate tax payers resident in India whose exports turnover for a year exceeds the export turnover for the immediately preceding year more than 10% thereof. The Finance Act, 1983, has omitted the aforesaid provision with effect from 1.4.1983. Simultaneously, a new Section 80HHC has been inserted with effect from the same date for providing deduction with reference to export turnover.” The subsequent amendments in 1992 by which clause (baa) to the Explanation to Section 80HHC was introduced, were explained in the CBDT Circular No. 621 dated 19.12.1991. Paras 32.5 to 32.7 of this Circular explain the purpose of introduction of the aforementioned Explanation and read as under:

“32.5 Under the existing provisions of sub-section (3) of Section 80HHC of the Income-tax Act, profit derived from the export of goods is computed in the following manner:

$$\frac{\text{Profits of the business} \times \text{Export turnover}}{\text{Total turnover}}$$

32.6 The application of this formula has given rise to some misuse. Many cases have come to notice where persons, who are not chargeable to income-tax, transfer their export turnover to business houses merely by endorsement of letter of credit



received by them. Business houses which “buy” these export turnover, get the benefit of deduction under Section 80HHC without any physical export of goods.

32.7 The tax concession under Section 80HHC is intended to compensate an exporter for the comparative disadvantage faced by him in the international market. With a view to ensuring that the tax concession is not misused, sub-section (3) of section 80HHC of the Income-tax Act has been amended.”

This Circular also clarifies certain other concepts that will be presently discussed.

A plain reading of the provision is indicative of the overall scheme which appears to be as follows:

(a) The assessee has to be an Indian company engaged in the business of exports out of India of any goods or merchandise.

(b) In computing the total income of such assessee, a deduction is allowed “to the extent of profits”, referred to in sub-section (1B) “derived by the assessee from the export of such goods or merchandise”.

(c) Sub-section (1B) specifies the extent of deduction of profits. In a graded scale this has been progressively reduced by the legislature from 80 per cent for the Assessment Year 2001-02 to 30 per cent for the Assessment Year 2004-05, after which this deduction has been done away with. Effectively, therefore, the benefit under Section 80HHC is no longer available to an assessee after the beginning of the Assessment Year on 1.4.2005.

(d) Where the business of the assessee is not exclusively of exports, sub-section (3) of Section 80HHC sets out a formula for determining the “profits derived from such export” for the purposes of sub-section (1). There are three situations envisaged here. The first is under clause (a) of sub-section (3) where the export out of India is of goods or merchandise manufactured by the assessee. In such a case the formula is as under:

$$\text{Profits derived from exports} = \text{Profits of the business} \times \frac{\text{export turnover}}{\text{total turnover}}$$

The expression ‘export turnover’ has been defined in clause (b), ‘total turnover’ in Clause (ba) and ‘profits of the business’ in clause (baa) of the Explanation.



The second situation as envisaged by clause (b) of sub-section (3) is where the export out of India is of trading goods. The formula in such instance is straightforward. It is as under:

Profits derived from exports = Export turnover in respect of trading goods – direct costs – indirect costs attributable to such export.

The third situation is in clause (c) of sub-section (3) where the export out of India is both of goods manufactured by the assessee and trading goods. In such event, to the extent of the manufactured goods the formula in the first situation will be adopted and in respect of the trading goods, the formula in the second situation will be adopted.

Then in each of the above instances the profits derived from exports is increased by an amount, which is derived by applying a multiplier to 90% of the export incentives, and is worked out as under:

$$90\% \text{ of amounts in S. 28 (iiia) to (iiic) } \times \frac{\text{export turnover}}{\text{total turnover}}$$

(e) Many of the present cases do not involve the second and third situations. They deal with the first situation where the export out of India is of goods or merchandise manufactured by the assessee. As already noticed in such a case the formula as spelt out by clause (a) of sub-section (3) of Section 80HHC is as under:

$$\text{Profits derived from exports} = \frac{\text{Profits of the business} \times \text{export turnover}}{\text{total turnover}}$$

(f) The expression “profits of the business” has been defined in Clause (baa) of the Explanation as under:

Profits of the business (POB) =

Profits computed under the head “profits and gains of business and profession” [‘PAGBP’] — 90% sums referred to in S.28 (iiia) to (iiie) [‘A’] — 90% receipts by way of brokerage, commission, interest, rent, charges or any other receipts of a similar nature included in such profits [‘B’] — Profits of any branch, office, warehouse or any other establishment of the assessee situate outside India [‘C’]

In other words, by using the symbols in the above equation, it can be further represented as under:



$$POB = PAGBP - 90 \% A - 90\% B - C$$

Thus profits derived from exports would be:

$$[PAGBP - 90 \% A - 90\% B - C] \times \frac{\text{export turnover}}{\text{total turnover}}$$

The use of the words ‘computed under the head “profits and gains of business and profession”’ in clause (baa) is a direct reference to the exercise of computation of business income in accordance with Sections 28 to 44 of the Act.

Questions and Issues

4.1 The questions that arise in this batch of appeals may be stated as under:

(a) Does the expression ‘profits derived from such export’ occurring in sub-section (3) read with Explanation (baa) restrict the profits available for deduction in terms of sub-section (1) to only those items of income directly relatable to the business of export?

(b) Does the expression ‘interest’ in Explanation (baa) connote net interest, i.e. the gross interest income less the expenditure incurred by the assessee for earning such income?

(c) If the expression ‘interest’ implies net interest, then should netting be allowed where the interest income is computed to be business income?

4.2 It must be clarified that not all the above three questions arise in each of the appeals in this batch. In some, question (a) arises and in some others, the other two questions. Nevertheless, since these questions are recurrent and there appears to be no direct decision by this Court, we think it appropriate to answer these questions by a common judgment.

4.3 The two broad issues that arise, in sequence, from the above three questions may be stated as under:

(i) The determination of the nature of interest income. In other words, the first step is to determine whether in a given case the income from interest is ‘business income’, as computed in terms of Sections 28 to 44 of the Act, or ‘income from other sources’ as determined under Section 56 read with Section 57;

(ii) The issue of netting of interest. This is in an extremely narrow compass. In other words whether, after the determination of interest income as business income, while making the deduction of ninety percent of interest therefrom in terms of Explanation (baa), the figure of gross or net interest should be accounted for.

Contentions of the Parties



5.1 We have heard the submissions of Mr. C.S. Aggarwal, learned Advocate with Mr. Salil Aggarwal and Mr. Prakash Kumar, Mr. Ajay Vohra along with Ms. Kavita Jha, Mr. Saubhagya Aggarwal, Dr. Narayanan with Ms. Meera Bhatia, Ms. Shashi M. Kapila, Mr. K.R. Manjhani and Mr. S.K. Khurana learned Advocates for the assesseees. For the Department, we heard the submissions of Ms. Prem Lata Bansal, learned Senior Standing Counsel with Ms. Sonia Mathur and Mr. Vishnu Sharma, Junior Standing Counsel.

5.2 The submission of the assesseees on the questions and issues vary in relation to the facts of their respective appeals. On the first issue relating to the determination of the nature of interest income, the contention of one set of assesseees is that even the interest earned on surplus funds parked by the exporter in fixed deposits would, for the purposes of Section 80HHC qualify as business income. Their submissions are as under:

(a) while there is no quarrel with the proposition that the interest income in question should be computed under the head "income from other sources" i.e., Section 56, the real issue is to find out the nature of the interest income in question.

(b) even if interest income is assessed under the head "Income from other sources", if interest income is seen to have arisen from a business activity or, in other words, it has a close nexus with the business carried on by the assessee then it will bear the imprint of or have the quality of business income for limited purposes.

(c) reliance is placed on the judgment of this Court in *Snam Progetti S.P.A v. CIT* 132 ITR 70 which has been upheld by the Hon'ble Supreme Court by the dismissal of the Special Leave Petition in 189 ITR (St.) 116. Here it was held that the question to be examined is whether the interest income was derived from what may be described as a business activity. If it is so derived then the mere fact that it is taxed under a different section will make no difference. It was held that in that case the income earned by way of interest from deposits which represented the spare funds of the assessee, would nevertheless constitute business income.

(d) reliance is placed on the CBDT Circular No. 564 dated 5.7.1990 which explains that the deduction could be of the profits of the business even though it could contain elements which were not strictly profits derived from the export of goods. This was further accepted by the Special Bench of the Tribunal in *Rajeev Enterprises v. Assessing Officer* 261 ITR (AT) 34.

(e) investment of surplus funds may not be business income in some cases, but where money necessarily has to be invested for the sake of carrying on the business, income if earned would be business income. Reliance is placed on *CIT v. Madras Motors Ltd.* 257 ITR 60 (Mad), *Vellore Electric Company*, *CIT v. Cocanada Radhaswami Bank Ltd.* 57 ITR 306 (SC).



5.3. A further argument that arises in these cases is that where on account of the conditionalities imposed by the banker, the assessee, for the purposes of obtaining letters of credit, bank guarantees and overdraft facilities for the purposes of its export business is constrained to keep monies in fixed deposit then the interest earned on such fixed deposits, should also be treated as business income. In other words, the assessee contends that if it can be determined whether in fact the placing of the amounts in fixed deposits bears a close proximity or is immediately preceding the availing of facilities from the bank for the purposes of export business, then the nexus between the placing of such fixed deposit and the export business is clearly established and in such event, there is no justification to exclude such income from reckoning for the purposes of the deduction under Section 80HHC on the ground that it is income from other sources.

5.4 A third set of assessee do not contest the fact that the question of netting would arise only where, as a result of the computation exercise in terms of Sections 28 to 44, the Assessing Officer (AO) determines the interest income to be business income. Their precise contention is that once interest income has been computed as business income, then netting has to be allowed. They contend that the entire clause (baa) has to be read along with the scheme of Section 80HCC(1) and (3) and given a meaning that will not produce absurd results. The interpretation should reflect a liberal construction conforming to the object of encouraging exports. By adopting such approach, it is urged that the Explanation "included in such profits" following the words "brokerage, commission, interest, rent, charges or any other receipts of a similar nature" is indicative of the fact that such amounts are the 'net' amounts and not the gross amounts because profits cannot be arrived at by any businessman without accounting for the expenditure incurred in earning such interest. Only such interest would be "included in the profits".

5.5 It is further urged that clause (baa) states that the "profits and gains of business or profession" have to be first 'computed'. This necessarily takes us to Sections 28 to 44 of the Act. The various stages in such computation, including Section 37, perforce envisage accounting for the expenditure incurred by an assessee for earning the income. The assessee further draw support from Circular No.621 dated 19.12.1991 and paragraph 30.11 thereof which states: "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 or such incomes is provided to account for these expenses".

5.6 The further argument is that wherever the Legislature intended to use the expression 'gross', it did so. In this regard, reference is made to the erstwhile



Section 80M, Sections 40(b), 44AB, 44AD and 115JB. The submission is that Legislature intended that the interest to be accounted for in computing the profits should be gross interest and not net interest then the provision would have been so worded. Reliance is placed on the decision in Distributors (Baroda) Pvt. Ltd. (1985) 155 ITR 120 (SC).

6.1 The submission on behalf of the Department on the first issue is that the words 'derived from' used in sub-section (1) and (3) of Section 80HHC necessarily brings in the nexus test. In other words, only such incomes that are directly relatable to exports would qualify for deduction. Also, not all receipts would qualify as income. The contention of Ms. Bansal is that in any of the following instances, the interest income of the exporter would not form part of the business income:-

- (i) interest received from surplus funds parked in fixed deposits with the bank;
- (ii) interest earned from fixed deposits which are kept as margin money to avail credit facilities for the export activity.

6.2 In support of the above propositions, reliance is placed upon the judgments of the Hon'ble Supreme Court in Parimisetti Seetharamamma v. CIT Andhra Pradesh (1965) 57 ITR 532 (SC), Tuticorin Alkali Chemicals & Fertilisers v. CIT (1997) 227 ITR 172 (SC), Pandian Chemicals Ltd. v. CIT (2003) 262 ITR 278 (SC) and of this Court in ACIT v. Natar Krishana Sehgal (1983) 141 ITR 681 (Del).

6.3 Reliance is next placed by the Department on the judgments of the High Courts interpreting Section 80HHC itself. These include that of the Madras High Court in K.S.Subbiah Pillai v. CIT (2003) 260 ITR 304 (Mad), the Punjab & Haryana High Court in Rani Paliwal v. CIT (2004) 268 ITR 220 (P& H), and the decisions of the Kerala High Court in Nanji Topanbhai v. ACIT (2000) 243 ITR 192 (Ker) and K.Ravindranathan Nair v. DCIT 2003 (262) ITR 669 (Ker). The contention is that once the interest income is categorized as 'income from other sources', it goes out of the ambit of Section 80HHC entirely.

6.4 On the second issue of netting, it is submitted on behalf of the Department that even where the interest income is determined to be business income, netting should not be permitted. It is submitted that there could be no casus omissus. In other words, the Court ought not to supply words when none exist. It is maintained that just as the assesseees argue that in this behalf if the Legislature intended that these receipts like commission, brokerage, interest had to be net interest, then clearly the Legislature would have said so and in the absence of such a clear enunciation, the word 'interest' has to be interpreted to mean 'gross interest'. Applying the strict rule of construction in interpreting the statutes, the Department urges that the expression 'interest' occurring in Clause (baa) can only mean gross



interest. A comparison is sought to be drawn between clauses (a) and (b) c section (3) to urge that the treatment in either case should be uniform.

6.5 It is urged that the Legislature has permitted the retention of 10 per cent of the interest income to compensate for the expenses laid out for earning such income and therefore a further deduction of the expenditure incurred for earning such interest, if permitted, would amount to a double deduction which clearly was not envisaged.

Nature of Interest income: Is it Business Income or Income from Other Sources?

7. The first issue that arises in these cases concerns the determination of the nature of the receipt by way of interest. The question is whether this is business income or income from other sources. It requires to be noticed that prior to certain amendments with effect from 1.4.1992, the deduction under 80HHC was also admissible in respect of business incomes which did not have an element of turnover. This was explained in CBDT Circular No. 564 dated 5.7.1990 [184 ITR 137 (SC)]. It was with the view to set right this anomaly that clause (baa) of Explanation to Section 80HHC was introduced with effect from 1.4.1992. The rationale for this change has been explained in CBDT Circular No.621 dated 19.12.1991, in paras 32.10 and 32.11. The ITAT in *International Research Park Laboratories v. ACIT* (1995) 212 ITR (AT) 1, interpreted CBDT Circular No. 621 dated 19.12.1991 and held that the profit earned by the assessee during the relevant assessment year (prior to 1.4.1992) from such commission was also profit derived from export since it 'would not have come to the assessee had he not been engaged in the export business.' This decision of the ITAT has been approved by the Hon'ble Supreme Court in *P.R. Prabhakar v. CIT* (2006) 284 ITR 548 (SC). This decision is, however, not immediately relevant for answering the issues that arise here.

The non-Section 80HHC decisions

8. A large number of decisions were cited by both sides on the first issue concerning the nature of the interest income. These decisions can be classified into two broad categories: the non-Section 80HHC decisions and the Section 80HHC decisions. In the first category, the leading decision is that of the Hon'ble Supreme Court in *Tuticorin Alkali Chemicals & Fertilisers* which holds that interest earned on deposits placed for the purposes of obtaining loans for business cannot be treated as business income but only as income from other sources. The decision in *Tuticorin Alkali Chemicals & Fertilisers*, which was rendered in the context of Sections 56 and 57, has been followed in *CIT v. Auto Kast Ltd.* (2001) 248 ITR 110 (SC). Likewise, in *CIT v. Dr. V.Gopinathan* (2001) 248 ITR 449 (SC) interest on fixed deposits was held not to qualify for setting off against interest on loans borrowed. The other



decisions on the same lines, in the context of Section 80HHC are CIT v. S Foods (1999) 237 ITR 579 and Pandian Chemicals (2003) 262 ITR 278 (SC). In these decisions, the Hon'ble Supreme Court reiterated the nexus theory and declined to treat such interest earned as business income. Significantly, the provision of the Act involved in these cases do not contain a machinery clause similar to clause (baa) to the Explanation below sub-section (4C) of Section 80HHC. Still, if one were to draw an analogy, an assessee who is engaged in the business of exports and invests the surplus funds in fixed deposits will not be able to treat the interest earned thereon as business income since it does not bear any direct nexus with the export business of the assessee.

9. On the distinction between the words 'attributable to' and 'derived from', the judgment of the Hon'ble Supreme Court in Cambay Electrical Supply Industrial Co. Ltd. v. CIT (1978) 113 ITR 84 is illustrative. It was held (ITR Page 93): "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." It was explained that the expression 'derived from' is a narrower concept and therefore unless nexus is shown between the income earned and the immediate and direct activity of the assessee, such income would not qualify as business income. This decision was followed in CIT v. Cochin Refineries Ltd. (1985) 154 ITR 345 (Ker) in the context of Section 80I and subsequently by the Hon'ble Supreme Court itself in Vellore Electric Corporation Ltd. v. CIT (1997) 227 ITR 557 (SC). The latter decision was rendered in the context of Section 80I which uses the words "profits and means attributable to any priority industry." The question that arose was whether the assessee was entitled to the relief under Section 80I even in respect of income earned by way of interest on the investment in securities of the amounts appropriated to the contingencies reserve, which was mandatorily required to be maintained by it in terms of the Electricity (Supply) Act, 1948. Answering the question in the affirmative, the Hon'ble Supreme Court held that the creation of the contingency reserve, being a condition statutorily incorporated "is incidental to the carrying on of the business of generation and distribution of electricity by the assessee." This decision is, however, distinguishable in its application to the present case in that Section 80HHC clearly uses the words 'derived from' and not 'attributable to'.

10. The judgment of the Calcutta High Court in Consolidated Fibers v. CIT (2005) 273 ITR 353 (Cal) was in the context of Section 56 read with Section 57(iii). The question was whether the interest paid on borrowed capital could go to reduce the income from short-term deposits during the relevant assessment year when the assessee had not commenced business. It was held that the interest income was



income from other sources and therefore the interest paid on the borrowed () could not be said to have been laid out or expended for the purposes of earning such income and therefore would not come within the purview of Section 57 (iii). Predictably, the High Court followed the judgment of the Hon'ble Supreme Court in Gopinathan, Auto Kast Ltd., Tuticorin Alkali Chemicals and CIT v. Bokaro Steel Ltd (1999) 236 ITR 315. The decision of the Hon'ble Supreme Court in CIT v. Karnal Cooperative Sugar Mills (2000) 243 ITR 2 was in the context of determining the nature of income earned by way of interest on the amounts deposited for opening a letter of credit for the purchase of machinery required for setting up a plant. It was held that the interest earned was a capital receipt since the deposit was incidental to the acquisition of assets. The decision of the Madras High Court in South India Shipping Corporation v. CIT (1999) 240 ITR 24 (Mad) was also rendered in the context of treating certain receipts not as business income but income from other sources for the purposes of Section 56 read with Section 57(iii) of the Act.

11. It is true that none of these cases considered or discussed a clause similar to clause (baa) of the Explanation below sub-section (4C) of Section 80HHC of the Act. If, as contended by counsels for both sides, Section 80HHC is a 'stand-alone' provision that has to be construed on its own wording, then these judgments may not be particularly helpful. Moreover, the wording of clause (baa) of the Explanation incorporates the entire procedure for computing business income under Sections 28 to 44 of the Act and in that context these decisions are not particularly helpful since they deal with instances of the treatment of income from other sources, referable to Section 56, and the allowing of netting for the purposes of earning such income.

12. We may end this part of the discussion by noting that de hors Section 80HHC, the approach generally is that where the statutory provision talks of 'income derived from' the business activity in question, the nexus theory should be applied in order to determine whether a particular item of income is business income or not. Now we turn to an examination of the decisions that have been rendered on an interpretation of Section 80HHC itself.

Section 80HHC decisions

13. In the context of Section 80HHC itself, the Madras High Court in K.S.Subbiah Pillai v. CIT (2003) 260 ITR 304 has held that if an assessee which is engaged in the business of exports, invests surplus funds in fixed deposits and earns interest thereon, such income cannot be treated as business income since it does not bear any direct nexus with the export business of the assessee.



14. In the following decisions, the Kerala High Court has consistently held the context of Section 80HHC the interest income earned on fixed deposits having to be kept by the assessee for availing of credit facilities from bank, does not qualify as business income and therefore, will go to reduce the deductible amount for the purposes of that Section:

- (i) Nanji Topanbhai v. ACIT (2000) 243 ITR 92
- (ii) Abad Enterprises v. CIT (2002) 253 ITR 319
- (iii) CIT v. Jose Thomas (2002) 253 ITR 553
- (iv) CIT v. Abad Fisheries (2002) 258 ITR 641
- (v) Southern Cashew Exports v. DCIT (2003) 130 Taxman 203
- (vi) ACIT v. South Indian Produce Co. (2003) 262 ITR 20
- (vii) K. Ravindranathan Nair v. CIT (2003) 262 ITR 669
- (viii) Urban Stanislaus Co. v. CIT (2003) 263 ITR 10
- (ix) GTN Textiles v. DCIT (2005) 279 ITR 72.

15. In particular, reference may be made to the observations in Urban Stanislaus Co. where the assessee had contended that as a condition for obtaining a loan from the bank, 20% of the sale receipts had to be deposited by way of security. It was claimed that the interest earned on such deposit was business income for the purpose of Section 80HHC. This was negated by the Kerala High Court by observing (ITR Page 12) that “the assessee can claim deduction in respect of the profits derived from the export of goods only when it is established that the income is solely related to the export. The obvious intention behind the provision in Section 80HHC is to promote exports. However, the income earned by way of interest from fixed deposit is not an income from exports. Thus, it was rightly taken into account as income from other sources.” This decision has been affirmed by the Hon’ble Supreme Court by the dismissal of the Special Leave Petition [order reported in 265 ITR (Statutes) 38].

16. In K. Ravindranathan Nair, in dealing with a similar issue, the Kerala High Court held (ITR page 673):

“The interest from short term deposits received by the appellant is not the direct result of any export of any goods or merchandise. The fixed deposit was made only for the purpose of opening letters of credit and for getting other benefits which are necessary requirements to enable the appellant to make the export. From the above it is clear that the interest income received on the short-term deposits though it can be attributed to the export business cannot be treated as income which is derived from the export business. In the above circumstances, even assuming that the bank had insisted for making short-term deposits for opening letters of credit and for other facilities, it cannot be said that the income is derived from the export business.”



The above decision in Ravindranathan Nair has been affirmed by the Hon'ble Supreme Court by the dismissal of the Special Leave Petition [order reported in 263 ITR (Statutes) 3]. To the same effect is the judgment of the same High Court in Southern Cashew Exports v. DCIT which has been affirmed by the Hon'ble Supreme Court on account of the dismissal of the Special Leave Petition [order reported in 264 ITR (Statutes) 142].

17. The resultant position is that on three occasions the Hon'ble Supreme Court has affirmed judgments of the Kerala High Court that has consistently held that 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 as business income. In each of these decisions, the Kerala High Court has consistently followed the earlier judgments listed at (i) to (iv) of para 14 above.

18. The decision of the Bombay High Court in CIT v. Punit Commercial Ltd. 245 ITR 550 (Bom) concerned a case where the assessee was a 100 per cent exporter. The High Court noticed that according to the Tribunal, the AO had proceeded on the footing that the interest income was business income, but that it was not income from exports. In those circumstances, the High Court held that since the entire business activity of the assessee is only of exports, "the entire business income is deemed to be profit derived from export of goods." It is not clear from the narration of the facts in Punit Commercial whether the interest earned was as a result of parking surplus funds in deposits. If it was so earned then it is difficult, in view of the decisions of the Kerala High Court that have been affirmed by the Hon'ble Supreme Court, to categorise such income as business income.

19. Turning to the submissions in the present cases, as regards the first of the categories, viz., the parking of surplus funds, there should be no difficulty at all. In view of the large number of the decisions of the Hon'ble Supreme Court in the context of Section 56 and Section 57 and those of the Kerala High Court in the context of Section 80HHC itself, we are unable to accept the contention of the assesses based on Snam Progetti that interest earned on parked surplus funds should qualify as business income. Clearly, Snam Progetti was not rendered in the context of Section 80HHC and cannot but be confined to the facts of that case. Circular No. 564 dated 5.7.1990 can also not help in interpreting Section 80HHC which is a 'stand alone' provision. We are therefore of the view that where surplus funds are parked with the bank and interest is earned thereon it can only be categorised 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.

20. The other category is where the exporter is required to mandatorily keep monies in fixed deposit in order to avail of credit facility for the export business. The argument on behalf of the assessee is that but for such a stipulation by the bank there was no need for the exporter to keep the money in fixed deposit and therefore the income earned from such fixed deposits bears a direct nexus to the business activity itself. Given the repeated affirmation by the Hon'ble Supreme Court of three judgments of the Kerala High Court on the same issue, we are inclined to follow the view expressed by the Kerala High Court on each of these occasions. We accordingly hold that 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. Question (a) and issue (i) are answered accordingly.

21. However, we must add a caveat here. This holding of ours will apply only where there is a specific finding by the AO that interest income is not business income. However, if in a given case the AO has held that the interest income is business income, and this has not been challenged by the Department thereafter, then that question ought not to be permitted to be reopened and the only question then will be if netting should be allowed.

22. There are cases before us where the AO has held that the interest income is business income and this has not been reopened or questioned thereafter by the Department or where this Court has not formulated such a question while admitting the appeal. Therefore, the only question that arises in such cases is whether having held such income to be business income, the AO would be justified in denying netting of interest. This is the question we proceed to address next.

Netting

23. Clause (baa) of the Explanation to Section 80HHC 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 not allowable and therefore ought to be treated as



income from other sources. Once the AO computes what is business income the AO proceeds to the next step of deducting 90 per cent of the receipts referred in clause (baa) of the Explanation to Section 80HHC in order to arrive at the profits derived from profits. It is at this stage that the questions (b) and (c) arise. To recapitulate these are:

(b) Does the expression 'interest' in Explanation (baa) connote net interest, i.e. the gross interest income less the expenditure incurred by the assessee for earning such income, or does it connote gross interest?

(c) If the expression 'interest' implies net interest, then should netting not be allowed where the interest income is computed to be business income?

The decision of the Supreme Court in 'Distributors (Baroda)'

24.1 In support of their submission that the words "receipts by way of brokerage, commission and interest" in clause (baa) denote the nature of the receipt and that the words following these words viz., "included in such profits" denote the quantum, the assessee places heavy reliance on the judgment in *Distributors (Baroda) P. Ltd. v. Union of India* (1985) 155 ITR 120 (SC). In this decision, the Constitution Bench of the Hon'ble Supreme Court was reconsidering its earlier decision in *Cloth Traders P. Ltd. v. Additional CIT* (1979) 118 ITR 243 (SC) where, in the context of Section 80M(1) of the Act a question arose whether the relief in respect of dividends received from a domestic company was available only in respect of the net dividend as computed for purpose of assessment and not the gross dividend. In order to appreciate the observations of the Court in this case, it may be useful to recall Section 80M as it then stood:

"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."



24.2 Overruling its earlier decision in Cloth Traders' case, the Hon'ble Su₁ Court now held (ITR Page 135):

“Income by way of dividends from a domestic company included in the gross total income would, therefore, obviously be income computed in accordance with the provision of the Act, that is, after deducting interest on monies borrowed for earning such income. If the income by way of dividends from a domestic company computed in accordance with the provisions of the Act is included in the gross total income or in other words, forms part of the gross total income, the condition specified in the opening part of sub-section (1) of Section 80M would be fulfilled and the provision enacted in that sub-section would be attracted.”

The Hon'ble Supreme Court clarified (ITR p. 134) that:

“Now when an amount by way of dividend is received by the assessee from the paying company, the full amount of such dividend would have suffered tax in the assessment of the paying company and it is obvious, that, in order to encourage inter-company investments, the Legislature intended that this amount should not bear tax once again in the hands of the assessee either in its entirety or to a specified extent. But the amount by way of dividend which would otherwise suffer tax in the hands of the assessee would be the amount computed in accordance with the provisions of the Act and not the full amount received from the paying company. Therefore, it is reasonable to assume that in enacting Section 80M, the Legislature intended to grant relief with reference to the amount of dividend computed in accordance with the provisions of the Act and not with reference to the full amount of dividend received from the paying company.”

24.3 The Hon'ble Supreme Court also dealt with the submission that the words “amounts which are included in the income” were used merely used as a convenient mode of describing the nature of the different items of income and were not indicative of their quantum. Ultimately, the Court held as under (ITR p. 136):

“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 in 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 v 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.”

24.4 Interpreting the word “such” occurring in Section 80M preceding the word “income”, the Hon'ble Supreme Court explained as under (ITR Page 136):

“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 into 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 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.”

24.5 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) where it was explained by the Hon'ble Supreme Court that the words “such” profits can only be understood as ‘computed in accordance with the provisions of the Act’, we are of the view that similar words in clause (baa) should partake of the same meaning. Applying the ratio of Distributors (Baroda), we hold that the legislative intent in using 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.

Interpretation of Statutes

25.1 The contention of the Department is that the word 'receipts' can only mean 'gross receipts' and that since the word 'net' does not occur in the Section, it cannot be supplied by the Court. Reliance was placed on the judgment in K.Venkata Reddy v. CIT (2001) 250 ITR 147 (SC) in support of this submission. On the other hand, it was contended by the assesseees that the language of the Section was unambiguous and therefore equally there was no need to supply the word ‘gross’ as qualifying the



word 'interest'. In other words, they contend that even the word 'gross' as con- by the Revenue is not present in the Section and therefore applying the same rule of causus omissus such word cannot be read into the Section.

25.2. We are inclined to adopt the approach explained by the Madras High Court in Commissioner of Income-Tax v. P.Manonmani 245 ITR 48 at 55 in the following words:

“While ascertaining the true scope of a provision in a statute, attention must necessarily be paid not only to the text, viz., the words employed in the relevant provision, but also the context. The Supreme Court in the case of Reserve Bank of India v. Peerless General Finance and Investment Co. Ltd. (1987) 61 Comp Case 663, observed: “Interpretation must depend on the text and the context. They are the bases of interpretation....”

25.3 We may also usefully refer to the observations of Hon'ble Supreme Court in CIT v. J.H.Gotla (1985) 156 ITR 323 at 339 in the following words:

“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. The task of interpretation of a statutory provision is an attempt to discover the intention of the Legislature from the language used. It is necessary to remember that language is at best an imperfect instrument for the expression of human intention. It is well to remember the warning administered by Judge Learned Hand that one should not make a fortress out of the dictionary but remember that statutes always have some purpose or object to accomplish and sympathetic and imaginative discovery is the surest guide to their meaning.”

25.4 There is also merit in the contention of the assesseees that an interpretation other than that suggested by them, i.e. interest in this context refers to net interest, might produce unintended or absurd results. A reference may be made to the decision of the Hon'ble Supreme Court in Keshavji Ravji & Co. v. CIT 183 ITR 1.

24.5 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 includable in arriving at the business profit.



25.6 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.

25.7 Support for this proposition is to be found from Circular No. 621 dated 19.12.1991 of the CBDT.

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

25.8 It has been urged that full effect has to be given to the CBDT Circular which acknowledges that 'receipts by way of brokerage, commission, interest' etc., are "incomes" and in order to give effect to this expression the principle of netting will have to be permitted to apply. In other words, while it is conceded that all receipts need not be incomes, the context in which the word is used in Explanation (baa) to Section 80HHC will necessarily have to mean such receipts (i.e. incomes) reduced by the expenditure laid out for earning such income. It must be said that the CBDT Circular could have been more happily worded. For instance, there was no need to add to the confusion by using the expression 'receipts' as well as 'incomes' in successive sentences while referring to the same item. The only way to reconcile this is to read the expression 'receipts by way of brokerage, commission, interest...' as referring to the nature of receipt, which in the context of Section 80HHC connotes 'income'. The Circular also could have taken note of the expression 'included any such profits' which follows the words 'receipts by way of brokerage, commission, interest...' in Explanation baa(i) itself. There is much force in the contention that what can possibly be included in the profits is such interest which has a potential of contributing to the profit of the business. This supports the argument that unless netting is permitted it will not be in sync with the entire Section.

25.9 There is one other contention of the assessee which merits acceptance. It is submitted that if the deduction of 90 per cent is of the gross interest itself, the amount



spent in earning such interest will remain on the debit side of the Profit and Loss account and will depress the profit to that extent. The idea of Section 80HHC is to ensure that the exporter gets the benefit of the profits derived from export and not to depress the profit further. Therefore, it can only be the net interest which can be included in the profits. If netting were not to be permitted the result would be that the profits of the exporter would be depressed by an item that is expenditure incurred on earning interest, which does not form part of the profit at all. This could not have been the intention of the legislature.

25.10 There is also no merit in the contention of the Department that the treatment of clause (a) of Section 80HHC (a) should be no different from clause (b) of the same sub-section. 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. For all of these reasons, we hold that 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.

The Tribunal's decision in Lal Sons Enterprises

26.1 Since much reliance has been placed by the assesseees on the decision of the ITAT in *Lalsons Enterprises v. DCIT* [2004] 89 ITD 25 (Del) (SB), we propose to discuss the decision at some length. At the outset it must be noticed that the Tribunal in *Lalsons* proceeded on the footing that in the batch of cases before it, no question was raised that interest income should be categorized as income from other sources. In other words, the judgment of the Tribunal proceeded on the footing that interest income was business income. This is clear from the following passage (ITD p.62):

“In the present case, however, the principle of netting is pressed into service not on the basis of the theory of real income (we did not hear any of the learned counsel or learned representatives of the assesseees/intervenors raise the plea) but on the basis of the computation provisions relating to the business income.”

One of the questions that arose before the Special Bench of the ITAT (ITD Page 35) was:

“Whether 90 per cent of the gross interest received by the assessee shall be reduced from the profit and gains of the business or profession to determine profits of the business as given in Explanation (baa) below sub-section 4(b) of Section 80-HHC of the Income Tax Act in order to compute the deduction under Section 80-HHC of the Income Tax Act or only 90 per cent of net receipt of the interest after allowing a set off of interest paid against the interest receipt?”

The ITAT re-phrased the issue and posed the question (ITD Page 58) as follows:



“Now when the legislature has fixed an ad hoc percentage as expenditure incurred to earn the receipts, can it be further argued that only the net income, which means gross receipt by way of commission, interest, rent, etc. minus all the expenditure which has a nexus with the receipt, can be excluded from the "profits of the business" as computed under the head "business"? Is there any warrant for such an argument?”

26.2 It then proceeded to answer the question (ITD Page 58) thus:

“On the language of Explanation (baa) there is reason to think there is. The ad hoc 10% deduction, given indirectly by saying that only 90% of the receipts will be excluded from the profits of the business as computed, instead of the entire receipts, has been given for common expenses, according to the circular. Such common expenses are generally the indirect or fixed expenses which every businessman has to incur to continue in business, such as salaries and wages, other administrative expenses and so on. In addition to such common expenses, there may be expenses which have a direct bearing or nexus with the receipts by way of interest, commission, brokerage, rent etc. If such receipts are to be taken out of profits of the business on the footing that they have no connection with the business profits or the turnover, it seems only fair and reasonable to hold that the expenditure having a nexus with such receipts should also be taken out of the business profits on the same footing. This conclusion is warranted, in our humble opinion, even on the language of clause (1) of the Explanation. The receipts that are to be excluded from the business profits are those which are "included in such profits". The word "receipts" used in the clause does not, in our view, refer to gross receipts merely because the word "net" is not used before it: nor does it mean, as was suggested on behalf of the Department, to denote what "actually comes in" or what is "actually received by the assessee". This is because of the controlling words, imposing a qualification or condition, which follow, to the effect that the receipts should be those that have been included in the business profits. In the computation of the business profits, only the net income arising out of the receipts are included.”

26.3. The Tribunal ultimately answered the question as under (ITD Page 64):

“For the purpose of applying Explanation (baa) below sub-section (4B) of Section 80HHC and while reducing 90% of the receipt by way of interest from the profits of the business, it is only the 90% of the net interest remaining after allowing a set off of interest paid, which has a nexus with the interest received, that can be reduced and not 90% of the gross interest.”

26.4 Two arguments of the Department have been answered in *Lalsons* by the Tribunal, with which are in agreement. The first is that if netting is allowed in respect of the receipts by way of interest, then even for the export incentives mentioned in Sections 28(iiiia), (iiib) and (iiic), the expenditure incurred by the



assessee would have to be deducted. In para 45 of its judgment (ITD Page 6), the Tribunal has dealt with this submission in detail and pointed out, how, given the nature of the receipt under these provisions, “no deduction for expenditure is contemplated.” The Tribunal has thus explained that this “is the reason why in clause (1) of Explanation (baa) the export incentives are treated as a separate category and the language employed is also different from the language employed to refer to the exclusion on account of receipts by way of brokerage, interest, etc., which are treated as a separate category of exclusion.” We fully concur with this reasoning.

26.5 The other contention that since already 10% deduction has been permitted for common expenses incurred in earning the receipts mentioned in Explanation (baa), no further ‘netting’ of expenditure is contemplated has been answered by the ITAT convincingly in para 40, which has already been extracted hereinabove. The ITAT has also negated the argument that receipts can only mean what actually comes in and what is actually received and not what goes out.

26.6 We affirm the decision of the Special Bench of the ITAT in *Lalsons Enterprises* that the expression ‘interest’ in clause (baa) of the Explanation to Section 80HHC connotes ‘net interest’ and not ‘gross interest’.

26.7 Question (b) is answered accordingly by holding that the word ‘interest’ in clause (baa) of the Explanation connotes ‘net interest’ and not ‘gross interest’.

Question (c): Is netting allowable on business income?

27. The last submission of the Department is that even if the interest earned is to be construed as part of the business income, the netting should not be permitted since the statute does not specifically say so. Reliance was placed on the judgment in *IPCA Laboratory Ltd. v. DCIT* (2004) 266 ITR 521, *CIT v. Chinnapandi* (2006) 282 ITR 389 and *Rani Paliwal v. C.I.T.* 2004 268 ITR 220.

28. In *Rani Paliwal* the High Court, without any detailed discussion simply held as follows: “A plain reading of clause (baa) of Explanation to section 80HHC of the Act makes this aspect quite clear and we are of the view that the Tribunal was right in disallowing the claim of the assessee in this regard.” We are afraid that there is no reasoning expressed by the High Court for arriving at such a conclusion. For instance, there is no discussion of the CBDT Circular and in particular para 32.11 thereof which indicates that netting is contemplated in Explanation (baa). Also it does not notice the effect of the words “included in such profits” following the words



“receipts by way of interest.....” in the said Explanation. We are therefore to subscribe to the view taken by Punjab and Haryana High Court in Rani Paliwal.

29. The Madras High Court in CIT v. Chinnapandi held that even where the interest receipt is treated as business income, the deduction within the meaning of Explanation (baa) is permissible only of the gross interest and not net interest. The High Court appears to have followed the earlier judgment in K.S.Subbiah Pillai & Co. without noticing that in K.S.Subbiah Pillai the interest receipt was treated as income from other sources and not as business income. Also, the High Court in Chinnapandi chose to follow Rani Paliwal, which as explained earlier gives no reasoning for the conclusion therein. Also, Chinnapandi does not advert to either the CBDT Circular or the judgment of the Special Bench in Lalsons, with which we entirely concur on this aspect. In particular, we entirely agree with the following formulation of the Special Bench of the Tribunal in Lalsons (ITD, p. 62):

“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 include 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 the interest receipt has to be allowed as a deduction and only the balance can be excluded from business profits.”

30. To the above, we may add a few lines by way of clarification. It will bear examination whether obtaining the loan and paying interest thereon (laying out the expenditure by way of interest) was “wholly and exclusively” for the purpose of earning the interest on the fixed deposit, to draw an analogy from Section 37. This nexus will have to be shown by the assessee for application of the netting principle.

31. For all of the above reasons we respectfully differ from the views expressed by the Punjab and Haryana High Court in Rani Paliwal and the Madras High Court in Chinnapandi.

32. We accordingly hold that 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. Question (c) is answered accordingly.