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

Judgment reserved on : 06.11.2008
% Judgment delivered on : 21.11.2008

+ **ITA No. 653/2007**

COMMISSIONER OF INCOME TAX ..... Appellant

versus

DELHI BRASS & METAL WORKS LTD ..... Respondent

Advocates who appeared in this case:

For the Appellant : Ms Prem Lata Bansal
For the Respondent : None

CORAM :-

HON'BLE MR JUSTICE BADAR DURREZ AHMED
HON'BLE MR JUSTICE RAJIV SHAKDHER

1. Whether the Reporters of local papers may be allowed to see the judgment ? Yes
2. To be referred to Reporters or not ? Yes
3. Whether the judgment should be reported in the Digest ? Yes

RAJIV SHAKDHER, J

1. This is an appeal under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as the 'Act') against the judgment dated 17.11.2006 passed by the Income Tax Appellate Tribunal (hereinafter referred as the 'Tribunal') in ITA No. 4688/Del/2003, in respect of, the assessment year 2001-02.

2. We may note that, even though by our order dated 06.11.2008 notice had been issued to the respondent/assessee, despite service, the assessee has not entered appearance. This left us, with no other alternative, but to hear the matter in the absence of the respondent/assessee.

3. The short question which has arisen for our consideration in the present appeal is, whether in the facts and circumstances, as found by authorities below in the instant case, the interest earned on fixed deposits kept by the respondent/assessee with the bank would enter the ring of profits under the provisions of Section 80 HHC of the Act. The other supplementary issue which arises for consideration is, whether the respondent/assessee ought to be allowed the benefit of 'netting' i.e. a set off, in respect of, interest received on fixed deposits kept with the bank, against the, interest paid to the bank on over draft facilities availed by the respondent/assessee from the bank.

4. In order to decide the issue, the following brief facts require to be noted :-

5. The assessee/respondent, who is a 100 percent exporter of readymade garments had surplus funds which were put in a fixed deposit with the bank. The said fixed deposits, in the assessment year in issue,

earned interest in the sum of Rs 23,14,800/-. The assessee who was required to furnish a bank guarantee to the AEPC for procurement of export quota, prevailed upon the bank, to furnish a bank guarantee, which was, secured by the fixed deposit held with the bank. The bank guarantee furnished on behalf of the respondent/assessee by the bank was a pre-condition for allotment of an export quota by the AEPC.

5.1 The respondent/assessee had also availed of over draft facility from the bank and on this count it paid to the bank, in the relevant assessment year, interest in the sum of Rs 16,99,413/-.

6. In the background of the aforesaid circumstances on 31.10.2001, the respondent/assessee filed its return of income for the assessment year 2001-02. On 12.06.2002 the return was processed under Section 143 (1) of the Act. On 19.02.2003, the respondent/assessee filed a revised return. It transpires that the respondent/assessee's return was picked up for scrutiny. Accordingly, a statutory notice under Section 143 (2) of the Act was issued and duly served upon the respondent/assessee. During the course of scrutiny, the Assessing Officer came across a credit entry in the sum of Rs 6,15,386, in the profit and loss account of the respondent/assessee, for the relevant assessment year on account of interest received from the bank. The respondent/assessee on being

queried, in respect of the interest credited to the profit and loss account, explained as under :-

"Receipt from Bank	Rs 23,14,800/-
Payment to Bank	Rs 16,99,413/-
Balance credited to Profit & Loss a/c	Rs 6,15,383/-"

7. The respondent/assessee's explanation in short was that it had credited a sum of Rs 6,15,383/- to its profit and loss account after netting the interest received from the bank on the fixed deposit against the interest paid to the bank, with respect to, the over draft facilities availed by it.

7.1 By an order dated 28.03.2003, the Assessing Officer, held that the income received from the bank had to be treated as income under the head "income from other sources" as it was not income which had direct nexus with exports made by the respondent/assessee and hence, could not be held as income derived from export of goods or merchandise as contemplated in Section 80 HHC of the Act. The Assessing Officer returned a categorical finding that the assessee had earned interest from the fixed deposit made from surplus funds and, therefore, interest earned from such fixed deposit could not partake the character of proceeds earned from exports.

8. Being aggrieved, the respondent/assessee filed an appeal with the Commissioner of Income-tax (Appeals) [hereinafter referred to as the 'CIT(A)']. The CIT(A) by his order dated 05.08.2003 sustained the view of the Assessing Officer that interest proceeds received from the bank had to be treated as "income from other sources" as it had no direct or immediate nexus with the export business of the respondent/assessee. On the issue of 'netting' of interest, the CIT(A) held that the same cannot be allowed as this was paid as interest on over draft facility, which was, utilized in the export business. The CIT(A), however, held that the interest paid by the respondent/assessee on overdraft facility having been incurred for the purpose of business, was allowable as deductions from business income. In other words, the CIT(A) held that interest paid on overdraft facility cannot be allowed as a deduction against the interest income which is chargeable to tax under the head "income from other sources" as it was not incurred in earning income by way of interest. The respondent/assessee being aggrieved carried the matter in appeal to the Tribunal. The Tribunal by a brief order allowed the appeal of the respondent/assessee. The Tribunal gave reasons which are contained in paragraph No. 6 of the impugned judgment, which reads as under :-

> "…..We have heard the parties and perused the record of the case. The assessee is a 100% exporter of garments. The interest has been received by the

> assessee on FDRs pledged with the banks for furnishing guarantee in favour of AEPC for procurement of Quota as it being a precondition to its allotment. Thus whatever FDRs were purchased by the assessee was on account of business exigencies and interest received there from was inextricably linked with the business interest income and interest paid is justified. Further, this issue squarely covered by the decision of the special Bench of ITAT, New Delhi in the case of Lal Sons Enterprises, 89 ITD 25 (Del) (SB). Assessing Officer is directed to compute the profit of the business under explanation (baa) of Sec. 80 HHC by deducting 90%net interest….."

9. As noted above, the Revenue being aggrieved has preferred the present appeal before us. The learned counsel for the Revenue, Ms Bansal, has submitted that, the impugned judgment deserves to be set aside in view of the judgment of this Court in the case ***CIT v. Sri Ram Honda Power Equip : (2007) 289 ITR 475.***

10. Having heard the learned counsel for the Revenue and perused the record of the case, we are of the view that the submissions of the learned counsel for the Revenue deserve to be accepted. In ***Sri Ram Honda*** *(supra)*, this Court has dealt with both situations i.e., where the assessee earns interest on account of 'parked surplus funds' as also where an exporter is mandatorily required to keep money in fixed deposit in order to avail credit facilities for export business. The discussion with

respect to both these situations is summarized in paragraphs 35 & 36 of the judgment at pages 496 and 497, which reads as under :-

> "35. Turning to be 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 80 HHC itself, we are unable to accept the contention of the assessees based on *Snam Proghetti* [1981] 132 ITR 70 (Delhi) that interest earned on parked surplus funds should qualify as business income. Clearly, *Snam Proghetti* [1981] 132 ITR 70 (Delhi) was not rendered in the context of section 80 HHC and cannot but be confined to the facts of that case. Circular No. 564, dated July 5, 1990 (see [1990] 184 ITR (St.) 137), can also not help in interpreting section 80 HHC 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 categorized as income from other sources.** This receipt merits separate treatment under section 56 of the Act which is outside the ring of the profit and gains from business and profession. **It goes entirely out of the reckoning for the purpose of section 80 HHC. To give effect to this position, the Assessing Officer 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 80 HHC, a consequence not intended to be brought about.
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> 36. 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 purpose of availing of credit facilities from the bank, does not have an immediate nexus with the export business and therefore has to necessarily be treated as income from other sources and not business income. Question (a) and issue (i) are answered accordingly."**

11. It is thus clear that, in both situations, this Court has held that interest earned does not have any immediate nexus with the export business and hence, will have to be treated as "income from other sources".

12. As regards the issue of the 'netting', it is observed from the discussion in ***Shri Ram Honda (supra)*** that it accepted the decision of the Special Bench of the Tribunal in ***Lal Sons Enterprises v. Dy Commissioner of Income Tax : (2004) 89 ITT 25.*** However, while doing so it analysed the decision of the Tribunal in ***Lal Sons Enterprises*** *(supra)* to determine its true scope. This is evident from observations made by this Court in Paragraph 58 at Page 503 of ***Shri Ram Honda*** *(supra)*, wherein it notes that the Tribunal, in ***Lal Sons Enterprises***

(supra) proceeded on the footing that no question was raised that interest should be categorized as "income from other sources". This Court after discussing the ratio of the Tribunal's judgment in Paragraph 63 at page 505 clearly held that they concur with the reasoning of the Tribunal in ***Lal Sons Enterprises*** *(supra)*. This is followed, with the Court concluding in paragraph 74(viii) and (ix), that the, interest in clause (baa) of the explanation connotes "net interest" and not "gross interest". Therefore, in deducting such interest, the Assessing Officer will take into account the net interest i.e, "gross interest" as reduced by the expenditure incurred on earning such interest. The aforesaid conclusions of the Court have to be read with the observations made in paragraph 70 & 71, wherein the Court has observed as follows:-

> "…… we entirely agree with the following formulation of the Special Bench of the Tribunal in Lal Sons [2004] 89 ITD 25 (Delhi) (page 62) :
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> > '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 the business profits.'
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> 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……"

13. A perusal of the aforesaid observations of this Court in ***Sri Ram Honda*** *(supra),* would show that the Tribunal, in the present case, has misconstrued the ratio of the decision of the Special Bench of the Tribunal in ***Lal Sons Enterprises*** *(supra).* As explained by this Court, in ***Lal Sons Enterprises*** *(supra),* the Tribunal was not called upon to determine as to whether the interest income earned by an assessee was to be categorized as "income from other sources". Furthermore, this Court after analyzing the ratio of the judgment of the Tribunal in ***Lal Sons Enterprises*** *(supra)* came to the conclusion that the 'netting' would be allowed of that expenditure by way of interest, which was, laid out 'wholly and exclusively' for the purposes of earning interest on fixed deposits. Applying the ratio of the judgment of this Court it has to be

said that, in the instant case, the respondent/assessee cannot be allowed to adjust by way of expenditure interest paid to the bank on overdraft facility against the interest received by it on fixed deposits kept with the bank as this was not the expenditure laid out 'wholly and exclusively' for the purpose of earning interest on fixed deposits. The Tribunal in the impugned judgment has clearly misconstrued the ratio of its own judgment in the case of ***Lal Sons Enterprises*** *(supra)*.

14. In the result, the impugned judgment of the Tribunal is set aside and that of the CIT(A) is sustained in view of the fact that the issues raised in the appeal are squarely covered by the judgment of this Court in ***Shri Ram Honda*** *(supra)*.

RAJIV SHAKDHER, J

BADAR DURREZ AHMED, J

November 21, 2008
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