

IN THE HIGH COURT OF JUDICATURE AT MADRAS

CORAM:

THE HONOURABLE Mr.JUSTICE T.S.SIVAGNANAM
and
THE HONOURABLE Mrs.JUSTICE V.BHAVANI SUBBAROYAN

Tax Case (Appeal) Nos.349 and 350 of 2008

Judgment reserved on 03.09.2018	Judgment pronounced on 02.11.2018
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M/s.Indian Additives Ltd.,
Express Highway,
Manali, Chennai-600 068.

.. Appellant in both the Appeals

-VS-

The Assistant Commissioner of Income Tax,
Company Circle II(3),
121, Nungambakkam High Road,
Chennai-600 034.

.. Respondent in both the Appeals

Tax Case Appeals filed under Section 260A of the Income Tax Act, 1961 against the orders of the Income-tax Appellate Tribunal Chennai Bench 'A', dated 07.12.2007 in I.T.A.No.61/Mds/2007 and dated 20.11.2007 in I.T.A.No.2507/Mds/2006 respectively for the assessment year 1998-1999.

For Appellant :
(in both the Appeals)

Ms.S.Sree Lakshmi Valli
for Mr.G.Baskar

For Respondent :
(in both the Appeals)

Mr.Karthik Ranganathan,
Senior Standing Counsel; and
Mr.S.Rajesh, Junior Standing Counsel

COMMON JUDGMENT

T.S.Sivagnanam, J.

These appeals have been filed by the Assessee M/s.Indian Additives Limited, challenging the orders passed by the Income Tax Appellate Tribunal Chennai "A" Bench, in ITA No.61/MDS/2007, dated 07.12.2007 and IN ITA No.2507/MDS/2006, dated 20.11.20017 for the Assessment Year 1998-1999 respectively.

2. T.C.A.No.349 of 2008 has been admitted vide order dated 25.06.2008 on the following substantial question of law:

"Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal is right in law in allowing the appeal of the Revenue and holding that the loss arising from foreign exchange fluctuation is an unascertained liability that has to be added back to the book profit as per Clause (c) of Explanation to Section 115JA of the Income Tax Act ?".

3. T.C.A.No.350 of 2008 has been admitted vide order dated 30.06.2008 on the following substantial question of law:

"Whether on the facts and in the circumstances of the case, the interest received from the employees and paid over to the HDFC on account of the loan availed by the employees from HDFC is income in the hands of the appellant and whether the same if treated as income is not eligible for relief under Section 80IB?".

3.1. In T.C.A.No.350 of 2008, learned counsel for the appellant has filed a memo raising an additional substantial question of law. Having considered the facts and circumstances, we deem it appropriate to frame the additional substantial question of law in T.C.A.No.350 of 2008, which is as follows :

“Whether on facts and in the circumstances of the case, the Income Tax Appellate Tribunal is right in law in holding that interest received on advances paid to suppliers cannot form part of business income for the purpose of deduction u/s.80IA of the Income Tax Act?”

4. Heard Ms.S.Sree Lakshmi Valli, learned counsel for the appellant and Mr.Karthik Ranganathan, learned Senior Standing Counsel for the Revenue.

5. The Assessee is a Joint Venture between an American company and an Indian company. For the Assessment Year 1998-1999, the Assessee filed return of income on 26.11.1998 admitting the total income of Rs.31,98,355/- under regular computation and Rs.4,67,73,600/- under Section 115JA of the Income Tax Act, 1961 (in short, “the Act”). An intimation under Section 143(3) of the Act was issued on 22.06.1999, pursuant to which, a scrutiny order was passed on 28.02.2001. Thereafter, a notice under Section 148 was issued on 22.03.2005 for the reason that the loss arising on account of foreign exchange fluctuation amounting to Rs.59,70,000/- was not allowable in the computation of income under Section 115JA of the Act, in so far as the same was an 'unascertained liability' for the purposes of computation of book profit under Section 115JA. Accordingly, the amount was treated as an unascertained liability and added back to the book profits in the computation of income under Section 115JA.

6. The Assessee filed an appeal against the order of assessment before the Commissioner of Income Tax (Appeals)-III [in short, "the CIT(A)"], contending that the loss, that arose was on account of fluctuation of foreign exchange, was an ascertained amount, in so far as the rate of foreign currency as on the last date of the financial year was adopted for the purposes of quantum of the amount. The Assessee relied upon the decision of the Tribunal in its own case for the two earlier years, which were decided in favour of the Assessee. Thus, it was argued that the conclusion of the Assessing Officer that the loss arising from the fluctuation of foreign exchange was an unascertained liability was erroneous. The CIT(A) allowed the appeal filed by the Assessee.

7. Challenging the same, the Revenue preferred an appeal to the Tribunal contending that the order of the Tribunal, which were referred to by the CIT(A) pertaining to two earlier years was with reference to the computation under the regular provisions and not under Section 115JA of the Act. The Revenue relied upon the decision of the Punjab and Haryana High Court in the case of **Sterling Steels and Wires Limited V. DCIT, 271 ITR 260 (P&H)**. The Assessee contended before the Tribunal that the earlier order passed by the Tribunal for two years is applicable in the facts of the instant case and the decision in the case of **Sterling Steels and Wires Limited** is distinguishable. However, the contention raised by the Assessee was rejected and the appeal filed by the Revenue was allowed holding that the foreign exchange fluctuation was an unascertained liability.

8. Challenging the same, the Assessee has filed T.C.A.No.349 of 2008.

9. The appeal in T.C.A.No.350 of 2008 also pertains to the very same Assessment Year 1998-1999, but a separate order came to be passed by the Tribunal dated 28.11.2007 with reference to deductions under Section 80IB of the Act and interest from deposits with the Tamil Nadu Electricity Board (in short, TNEB) and interest received from Housing and Vehicle Loans advanced to employees, and also interest charged on advances paid to suppliers.

10. In the return of income filed on 26.11.1998 for the Assessment Year 1998-1999, the Assessee claimed deduction under Section 80IB in respect of its business income. The return was selected for scrutiny and order was passed on 30.01.2006, wherein, the Assessing Officer restricted the deduction claimed under Section 80IB and held that the following would be ineligible for deduction under Section 80IB, namely,

- (i) interest from deposits with TNEB ;
- (ii) interest received from Housing and Vehicle Loans advanced to its employees ;
- (iii) interest on advances made to suppliers ; and
- (iv) Discounts from suppliers and service providers.

11. The Assessee filed an appeal before the CIT(A), who accepted the Assessee's contention in respect of item Nos.(i) and (iv) supra and rejected the Assessee's contention in respect of item Nos.(ii) and (iii) supra. Aggrieved by that

portion of the order passed by the CIT(A), the Assessee filed an appeal before the Tribunal contending that for the purpose of its business activities, it had applied for an HT electricity service connection with TNEB and to obtain sanction of the same, a mandatory Caution Money Deposit has to be made, without payment of which, the electricity connection will not be provided. It was contended that since the activities carried on by the Assessee required the aid of power, the Caution Money Deposit was made by the Assessee, which earned interest and this interest has a direct nexus with the industrial undertaking and is derived from the same, in so far as the activities of the industrial undertaking would be unable to function, without electricity and therefore, the said amount of interest is eligible for deduction under Section 80IB of the Act.

12. With regard to the interest received from Housing Loans and Vehicle Loans advanced to its employees, the Assessee contended that till 31.01.2000, they were virtually a Government Company as 70% of the equity was held by a Government Company and subsequent to restructuring, the holding of the Government Company was reduced to 50%. Prior to restructuring, the Assessee adopted the practice followed by other Government companies by disbursing housing loans to employees. For such purpose, the Assessee entered into an arrangement with M/s.HDFC, who would disburse loans to the Assessee at market rate, which, in turn, would be disbursed to the employees by the Assessee at concessional rate of interest. The consistent practice of the Assessee was to utilise the concessional interest recovered from the employees to defray the interest charges paid by it to M/s.HDFC and the balance was treated as employee costs,

which is allowable business expenditure. Therefore, the Assessee contended that apart from being a partial reimbursement of the expenditure incurred by the Assessee, the same is directly derived from the industrial undertaking and are integral and vital to its very existence.

13. The Tribunal, by order dated 20.11.2007, dismissed the appeal filed by the Assessee and while doing so, relied on the decision of the Hon'ble Supreme Court in the case of **CIT V. Pandian Chemical Limited, 262 ITR 278**, wherein, it was held that the expression "derived from" was narrower in application than the expression "attributable to". Challenging the said order, the Assessee had preferred an appeal in T.C.A.No.350 of 2008.

14. We first take up for consideration T.C.A.No.349 of 2008. The question to be decided is : Whether the loss arising from foreign exchange fluctuation is an unascertained liability required to be added back to the book profit as per Clause (c) of Explanation to Section 115JA of the Act.

15. The Assessee's contention is that such loss arising from the foreign exchange fluctuation was determined with reference to rate of foreign exchange as on the last date of the financial year and was, therefore, an ascertained liability for the purpose of Clause (c) of Explanation to Section 115JA of the Act. The further case of the Assessee is that the decision in **Sterling Steels and Wires Limited**

is distinguishable on facts and that the Tribunal erred in not following the decision in the Assessee's own case.

16. Ms.S.Sree Lakshmi Valli, learned counsel for the appellant contended that for the import, the Assessee had to effect payments on or before 31st March of the relevant year and the amount having not been paid, the rate of the foreign exchange as on 31st March was taken into account and accordingly, the same was calculated and therefore, it cannot be treated as an unascertained liability.

16.1. Learned counsel referred to the decision in **CIT V. Woodward Governor India (P) Ltd., (2009) 312 ITR 0254** and submitted that the income of the Assessee is decided only in terms of the system of accounting and therefore, the accounting method followed by an Assessee continuously for a given period of time needs to be presumed to be correct, till the Assessing Officer comes to the conclusion, for reasons to be given, that the system does not reflect true and correct profits.

16.2. Referring to paragraph 19 of the said decision, it was pointed out that in the said case, the Accounting Standard No.11 was adopted and the effect of the exchange difference was taken in the profit and loss account and the Court, referred to the decision in the case of **Sutlej Cotton Mills Ltd. V. CIT, (1979) 116 ITR 1 (SC)**, wherein, it was held that where the profit or loss arises to an assessee on account of appreciation or depreciation in the value of foreign currency held by it, on conversion into another currency, such profit or loss would ordinarily be a trading profit or loss, if the foreign currency is held by the Assessee on Revenue account or as a trading asset or as a part of circulating capital

embarked in the business, however, on the other hand, if the foreign currency is held as a capital asset or as fixed capital, such profit or loss would be of capital in nature.

16.3. Reliance was placed on the decision of the Hon'ble Supreme Court in **CIT V. Chowgule and Company Limited, (1996) 218 ITR 0384 (SC)** to buttress the submission that as on 31st March it is a gain or loss and not provision.

16.4. In the case of **Chowgule and Company**, the vires of Rule 115 of the Income Tax Rules, 1962, were put to challenge stating that it is in conflict with the substantive provision of the Act and was *ultra vires* of the Act. While rejecting the challenge to the rule and holding that Rule 115 cannot be struck down as being *ultra vires* of the provision of the Act, the Hon'ble Supreme Court pointed out that the Assessee was entitled to receive the price of the goods sold in foreign exchange and therefore, Rule 115 was clearly attracted and the amount of foreign exchange received by the Assessee will have to be valued on the last day of the accounting period on the basis of the rate prevalent on that day.

16.5. Learned counsel referred to Section 211 of the Companies Act, 1956 and in particular, Sub-section 3A and 3B, which mandates that the accounting standards have to be followed. It is submitted that what was done by the Assessee is not a provision, but an ascertained liability. Learned counsel for the Assessee also referred to the annual report of the Assessee for the year 1997-1998.

16.6. Reliance was placed on the decision of the Hon'ble Supreme Court in the case of **Apollo Tyres Ltd., V. CIT, (2002) 255 ITR 0273 (SC)** for the proposition that while assessing a company for income tax under Section 115J,

the correctness of the profit and loss account prepared by the Assessee and certified by the Statutory Auditors of the company and prepared in accordance with the requirements of Parts II and III of Schedule VI to the Companies Act, 1956 cannot be examined by the Assessing Officer and the Assessing Officer does not have the jurisdiction to go behind the net profit shown in the profit and loss account, except to the extent provided in the Explanation to Section 115J.

16.7. Relying upon the Assessee's own case in TC.A.No.1151 to 1153 of 2007, dated 18.12.2012, for the Assessment Years 1996-1997, 1997-1998 and 1998-1999, it is submitted that the said decision was rendered in favour of the Assessee by following the decision of the Hon'ble Supreme Court in the case of **ONGC Ltd., V. CIT, (2010) 322 ITR 180 (SC)**. Therefore, it is contended that loss on account of foreign exchange fluctuation is allowable in respect of payments not yet made as at the close of the relevant accounting year. It is further submitted that loss, where, the accounting was on mercantile basis, on account of foreign exchange fluctuation could be claimed and deducted even in a year prior to the payment in foreign exchange.

16.8. Referring to the decision in the case of **CIT V. American Power Conversion (India) Pvt. Ltd.,** (T.C.A.No.1373 of 2007, dated 04.04.2014), it is contended that loss arising out of fluctuation in foreign exchange for restatement of liabilities as at the end of the financial year is not contingent liability.

16.9. Reliance was placed on the decision of the High Court of Bombay in the case of **CIT V. Echjay Forgings (P) Limited, (2001) 251 ITR 0015 (Bom.),** for the contention that the provision for increased liability on account of fluctuation in foreign exchange rates, which was debited to the profit and loss

account prepared under the Companies Act were not to be added back to net profit as shown in the profit and loss account as per Explanation to Section 115J (1A).

16.10. Placing reliance on the decision of the High Court of Punjab and Haryana in the case of **CIT V. NHPC Limited, (2018) 101 CCH 0360 (PHHC)**, it was contended that in computing the book profits under Section 115JB as well as in normal income, provisions for loss in hedging transaction were not an unascertained liability.

17. Mr.Karthik Ranganathan, learned Senior Standing Counsel for the Revenue, submitted that foreign exchange is volatile and hence, it has to be treated as an unascertained liability. It is further submitted that the decision in the assessee's own case in T.C.A.No.1151 and 1153 of 2007 was in respect of deduction under Section 37, which was allowed by accepting it as an ascertained liability and not otherwise.

17.1. Learned counsel sought to sustain the order passed by the Tribunal by contending that the Tribunal rightly held that the exchange fluctuation is not an ascertained liability on the date of balance sheet and the liability is to be ascertained only on the date of payment and hence, the Explanation (c) to Section 115JA is squarely applicable to the facts of the case, and therefore, the order passed by the Tribunal calls for no interference.

18. With regard to interest received from the deposits with TNEB, interest

received from Housing and Vehicle Loans and interest received from Advances paid to suppliers, learned counsel for the Assessee relied upon the decision of this Court in the case of **Arul Mariammal Textiles Limited V. ACIT, (T.C.A.No.909 of 2008, dated 07.08.2018)**, wherein, the Assessee was required to furnish a fixed deposit, which was a pre-condition to enable the Assessee to open a foreign Letter of Credit for the purpose of import of critical components for manufacture of wind mill and this incidentally had earned some interest and it was held that such income is not liable to be assesseed and is eligible to be claimed as deduction.

18.1. Reliance was placed on the decision of this Court in **CIT V. The Madras Motors Ltd., (2002) 257 ITR 0060 (Mad.)**, wherein, it was held that the interest earned by the Assessee on belated payments from purchase of product was directly relatable to the business of the Assessee and the true test would be whether such interest would be available to the Assessee otherwise also and the answer to the question would be certainly in negative.

19. Learned counsel for the Revenue would contend that the income should come from the core activity and in the instant case, the core activity is not giving loans and advances to the employees nor giving advances to suppliers. Further, it is submitted that the need to give advances to suppliers is not always compulsory and therefore, the Tribunal rightly rejected the contention advanced by the Assessee. It is further submitted that the Tribunal rightly placed reliance on the decision of the Hon'ble Supreme Court in **Pandian Chemicals Ltd. V CIT (2003) 129 Taxman 539 (SC)**, wherein, it was held that the derivation of interest or profits on deposits with TNEB could not be said to be flowing directly

from the industrial undertaking and therefore, deduction for the same could not be allowed. Learned counsel after referring to Sections 80IB1 and 80IB3, referred to the decision of the Hon'ble Supreme Court in **Liberty India V. CIT, (2009) 183 Taxman 349 (SC)**, to explain the scope of Section 80IB. It is submitted that liberal interpretation cannot be given to Section 80IA, 80IB and 80IC as they are beneficial provisions and strict construction has to be given. Thus, the argument on behalf of the Revenue is that the expression "derived from" has to be narrowly construed.

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20. In this appeal, the assessee challenges the order passed by the Tribunal dated 07.12.2007 relating to the assessment for the year 1998-1999, vide assessment order dated 30.01.2006.

21. The assessee offered taxable income under Section 115JA of the Act and while computing book profit, the assessee did not add back the loss arising from exchange fluctuation. The Assessing Officer observed that it is an unascertained liability and hence, should be added back. Hence, the assessment was reopened and a notice under Section 148 of the Act was issued. In response thereto, the assessee contended that it is an ascertained liability and has been made based on the market rate of exchange available at the last date of the previous year. The Assessing Officer held that loss is not ascertained, as it crystallises only at the time of payment of dues to the foreign creditors.

22. Further, the Assessing Officer held that what the assessee claimed is a notional loss and not an actual loss. Accordingly, it was held that it was not an ascertained one, not allowable as an expenditure in computation of book profit under Section 115JA. Thus, treating it as an unascertained liability, added the same to the book profit.

23. On appeal before the CIT(A), the CIT(A) followed the decision of the Tribunal in the assessee's own case for the assessment years 1996-97 to 1998-99 and directed the Assessing Officer to delete the said amount of Rs.59.70 Lakhs from the book profits.

24. The Revenue filed appeal before the Tribunal contending that the decision of the Tribunal in the assessee's own case for the assessment years 1996-97 to 1998-99 had not attained finality and the said decision was rendered in the context of normal computation (deduction) and the CIT(A) should have appreciated that only provision for ascertained liability can be allowed under Section 115JA. The Tribunal accepted the case of the Revenue holding that the earlier order passed by the Tribunal was not in relation to the computation of book profit under Section 115JA but, relating to computation of income in normal course. The Tribunal referred to Explanation (c) to Section 115JA. Further, it held that exchange fluctuation is not an ascertained liability on the date of balance sheet, as the liability is ascertained only on the date of payment and the Explanation (c) to Section 115JA is squarely applicable and reversed the decision

of the CIT(A).

25. In **Woodward Governor India (P) Ltd.** (supra), two substantial questions of law arose for consideration, which were considered by the Hon'ble Supreme Court, viz.,

(i) Whether the assessee is entitled to adjust the actual cost of the imported assets acquired in foreign currency on account of fluctuation in the rate of exchange at each balance sheet date, pending actual payment of varied liability? and

(ii) Whether the additional liability arising on account of fluctuation in the rate of exchange in respect of loans taken for revenue purposes could be allowed as deduction under Section 37(1) of the Act in the year of fluctuation in the rate of exchange or whether the same could be allowed in the year of repayment of such loans?

26. The assessee contended that the valuation of asset and liability is a matter of accounting system, the Assessing Officer cannot depart from the existing accounting system without giving reasons for such departure and the existence of liability stands crystallized on the date of contract and it has nothing to do with payment and valuation of liability at a later date. It was further contended that the income of the assessee is decided only in terms of the system of accounting.

Thus, the contention was that the accounting method followed by an assessee continuously for a given period of time needs to be presumed to be correct, till the

Assessing Officer comes to the conclusion for reasons to be given that the system does not reflect true and correct profits.

27. Further, it was held that having come to the conclusion that the valuation is a part of the accounting system and having come to the conclusion that business losses are deductible under Section 37(1) on the basis of ordinary principles of commercial accounting and having come to the conclusion that the Central Government has made Accounting Standard No.11 mandatory, the Court proceeded to examine the said Accounting Standard. Ultimately, the Court held that the loss suffered by the assessee therein on account of the exchange difference as on the date of the balance sheet is an item of expenditure under Section 37(1) of the Act.

28. In **American Power Conversion (India) Pvt. Ltd.** (supra), the substantial question of law, framed for consideration, was whether the Tribunal was right in setting aside the order of the CIT and holding that loss arising out of fluctuation in foreign exchange for restatement liabilities as at the end of the financial year is not a contingent liability. The Division Bench, following the decision of the Hon'ble Apex Court in **ONGC Ltd.** (supra), held that the restatement of the liability itself came at the end of the accounting year on account of the foreign exchange fluctuation and thereby, the assessee was stated to have been saddled with the loss arising out of the restatement of the liability.

Following the decision in **ONGC Ltd.** (supra), it was further held that the restatement had come at the end of the accounting year and the liability itself was

on account of exchange fluctuation and accordingly, the appeal filed by the Revenue was dismissed.

29. In **Apollo Tyres Ltd.**, (supra), the Hon'ble Apex Court held that while assessing a company for income tax under Section 115J, the correctness of P & L account prepared by the assessee and certified by the statutory auditors of the company as having been prepared in accordance with the requirements of Part II and Part III of Schedule VI to the Companies Act, 1956 cannot be examined by the Assessing Officer and he does not have jurisdiction to go behind the net profit shown in the P & L account except to the extent provided in the Explanation to Section 115J.

30. In **Echjay Forgings (P) Limited** (supra), the substantial question of law, which fell for consideration before the High Court of Bombay was whether the Tribunal erred in law in holding that the provisions made for foreign exchange difference, doubtful debts etc. could not be added to the net profit shown in the P & L account within the meaning of Explanation to Section 115J(1A) while working out the book profit under Section 115J of the Act. With regard to the fluctuation in the foreign exchange rates, it was held that the Assessing Officer has to go by the computation of book profit as permitted under the Companies Act and for the purposes of Section 115J, book profit will be the net profit as shown in the P & L account prepared in accordance with Schedule VI to the Companies Act, 1956 subject to certain adjustment and upheld the order passed by the Tribunal which on facts held that the said amount has been debited to the P & L account under

the Companies Act, 1956 and therefore, faulted the Department in adding the said amount to net profits.

31. In the case of **NHPC Limited** (supra), the High Court of Punjab and Haryana with regard to the computation of book profits under Section 115JB, followed the decision of the Hon'ble Apex Court in **Woodward Governor India (P) Ltd.** (supra) and upheld the order passed by the Tribunal in deleting the addition made by the Assessing Officer in computing book profits under Section 115JB in respect of provision for loss in hedging transactions which according to the Revenue was an unascertained liability. The operative portions of the judgment read as follows:-

"13. The Assessing Officer added this amount in computation of the book-profit for the purpose of minimum alternate tax under section 115JB holding that the amount was merely provisional and at the time of actual repayment of loan the position may vary resulting in a profit. He held, therefore, that this was not an ascertained liability. Accordingly, the Assessing Officer added the amount of Rs.23 crores to the book-profit under section 115JB as well as to the normal income.

14. The Tribunal noticed that accounting standard 11 issued by ICAI deals with the issue of accounting for fluctuation in foreign exchange rates as impacting the current assets and liabilities. The Tribunal rightly placed reliance upon a judgment of the Supreme Court in Commissioner of Income Tax v. Woodward Governor India P. Ltd., [2009] 312 ITR 254 (SC). Although the ratio in paragraph 15 is sufficient to answer the questions under consideration, we intend referring to the process of reasoning leading to it as well. In that case, the Supreme Court raised the following question and made the following observations in regard thereto:-

"3. In this batch of civil appeals, the following questions

arise for determination: (i) Whether, on the facts and circumstances of the case and in law, the additional liability arising on account of fluctuation in the rate of exchange in respect of loans taken for revenue purposes could be allowed as deduction under Section 37(1) in the year of fluctuation in the rate of exchange or whether the same could only be allowed in the year of repayment of such loans?

13. As stated above, one of the main arguments advanced by the learned Additional Solicitor General on behalf of the Department before us was that the word "expenditure" in Section 37(1) connotes "what is paid out" and that which has gone irretrievably. In this connection, heavy reliance was placed on the judgment of this Court in *Indian Molasses Co.* [AIR 1959 SC 1049 : (1959) 37 ITR 66] Relying on the said judgment, it was sought to be argued that the increase in liability at any point of time prior to the date of payment cannot be said to have gone irretrievably as it can always come back. In *Indian Molasses Co.* case [AIR 1959 SC 1049 : (1959) 37 ITR 66], the Supreme Court was considering the meaning of the expression "expenditure incurred" while dealing with the question as to whether there was a distinction between the actual liability in praesenti and a liability de futuro. The word "expenditure" is not defined in the 1961 Act. The word "expenditure" is, therefore, required to be understood in the context in which it is used. Section 37 enjoins that any expenditure not being expenditure of the nature described in Sections 30 to 36 laid out or expended wholly and exclusively for the purposes of the business should be allowed in computing the income chargeable under the head "profits and gains of business". In Sections 30 to 36, the expressions "expenses incurred" as well as "allowances and depreciation" have also been used. For example, depreciation and allowances are dealt with in Section 32. Therefore, Parliament has used the expression "any expenditure" in Section 37 to cover both. Therefore, the expression "expenditure" as used in Section 37 may, in the circumstances of a particular case, cover an amount which is

really a "loss" even though the said amount has not gone out from the pocket of the assessee.

14. In *M.P. Financial Corpn. v. CIT* [(1987) 165 ITR 765 (MP)] the Madhya Pradesh High Court has held that the expression "expenditure" as used in Section 37 may, in the circumstances of a particular case, cover an amount which is a "loss" even though the said amount has not gone out from the pocket of the assessee. This view of the Madhya Pradesh High Court has been approved by this Court in *Madras Industrial Investment Corpn. Ltd. v. CIT* [(1997) 4 SCC 666 : (1997) 225 ITR 802]. According to *Law and Practice of Income Tax* by Kanga and Palkhivala, Section 37(1) is a residuary section extending the allowance to items of business expenditure not covered by Sections 30 to 36. This section, according to the learned author, covers cases of business expenditure only, and not of business losses which are, however, deductible on ordinary principles of commercial accounting (see p. 617, Vol. I of the 8th Edn.). It is this principle which attracts the provisions of Section 145. That section recognises the rights of a trader to adopt either the cash system or the mercantile system of accounting. The quantum of allowances permitted to be deducted under diverse heads under Sections 30 to 43-C from the income, profits and gains of a business would differ according to the system adopted. This is made clear by defining the word "paid" in Section 43(2), which is used in several sections i.e. Sections 30 to 43-C, as meaning actually paid or incurred according to the method of accounting upon the basis on which profits or gains are computed under Sections 28/29. That is why in deciding the question as to whether the word "expenditure" in Section 37(1) includes the word "loss" one has to read Section 37(1) with Section 28, Section 29 and Section 145(1). One more principle needs to be kept in mind. ITA-136-2015 - 12 - account the value of the stock-in-trade at the beginning and at the end of the year should be entered at cost or market price, whichever is the lower. This is how business profits arising during the year need to be

computed. This is one more reason for reading Section 37(1) with Section 145. For valuing the closing stock at the end of a particular year, the value prevailing on the last date is relevant. This is because profits/loss is embedded in the closing stock. While anticipated loss is taken into account, anticipated profit in the shape of appreciated value of the closing stock is not brought into account, as no prudent trader would care to show increased profits before actual realisation. This is the theory underlying the rule that closing stock is to be valued at cost or market price, whichever is the lower. As profits for income tax purposes are to be computed in accordance with ordinary principles of commercial accounting, unless, such principles stand superseded or modified by legislative enactments, unrealised profits in the shape of appreciated value of goods remaining unsold at the end of the accounting year and carried over to the following year's account in a continuing business are not brought to the charge as a matter of practice, though, as stated above, loss due to fall in the price below cost is allowed even though such loss has not been realised actually. At this stage, we need to emphasise once again that the above system of commercial accounting can be superseded or modified by legislative enactment. This is where Section 145(2) comes into play. Under that section, the Central Government is empowered to notify from time to time the accounting standards to be followed by any class of assessee or in respect of any class of income. Accordingly, under Section 209 of the Companies Act, mercantile system of accounting is made mandatory for companies. In other words, accounting standard which is continuously adopted by an assessee can be superseded or modified by legislative intervention. However, but for such intervention or in cases falling under Section 145(3), the method of accounting undertaken by the assessee continuously is supreme. In the present batch of cases, there is no finding given by the AO on the correctness or completeness of the accounts of the assessee. Equally, there is no finding given by the AO stating that the assessee has not complied with the accounting

standards.

15. For the reasons given hereinabove, we hold that, in the present case, the "loss" suffered by the assessee on account of the exchange difference as on the date of the balance sheet is an item of expenditure under Section 37(1) of the 1961 Act." (emphasis supplied)

The judgment of the Supreme Court clearly applies to the present case. The Tribunal, accordingly, rightly deleted the addition."

32. The Revenue seeks to sustain the order passed by the Tribunal on the ground that the exchange fluctuation is not an ascertained liability on the date of balance sheet and it is only a provision and the liability will become an ascertained liability only on the date of payment and therefore, Explanation (c) to Section 115JA is squarely applicable and the order passed by the Tribunal is just and proper.

33. To be noted that in the assessee's own case in T.C.(A) Nos.1151 to 1153 of 2007, identical question was considered in the sense as to whether the Tribunal was right in holding that the loss, where the accounting was on mercantile basis, the loss on account of exchange fluctuation could be claimed and deducted even in a year prior to the payment in foreign exchange. The assessee, for the relevant assessment year, claimed loss on exchange fluctuation, which was disallowed by the Assessing Officer on the ground that the loss suffered at the time of actual payment would be allowable in the year in which such remittance is made.

34. The Division Bench after taking note of the decision in **ONGC Ltd.** (supra), dismissed the appeals filed by the Revenue in fact, the CIT(A) applied the decision in the assessee's own case, in T.C.(A) Nos.1151 to 1153 of 2007 dated 18.12.2012, and allowed the assessee's appeals.

35. The Revenue seeks to distinguish the said judgment on the ground that the said decision was rendered in the context of normal computation.

36. Mr.Karthik Ranganathan, learned Standing Counsel strenuously contended that the scheme of Section 115J is a complete code by itself and a decision rendered in respect of a deduction under Section 37 of the Act cannot be made applicable. This very question was considered in the case of **NHPC Limited** (supra), in which one of the questions, to be precise question no.6 was relating to computation of book profits for the purpose of Minimum Alternate Tax (MTA) under Section 115JB. In the said case, the Assessing Officer held that the amount was merely provisional and at the time of actual repayment of loan, the position may vary resulting in a profit and therefore, it was not an ascertained liability. Though before us the Revenue contended that the assessee has made only a provision, we find that nowhere in the assessment proceedings such a statement was made. Even while passing the assessment order, the Assessing Officer has shown the same as loss on account of exchange fluctuation and not as a provision.

Therefore, in our considered view, the substantial question of law framed for consideration in the case on hand, requires to be answered in favour of the

assessee.

37. In the result, T.C.(A) No.349 of 2008 is allowed and the substantial question of law, framed for consideration, is answered in favour of the assessee and against the Revenue. No costs.

T.C. (A) No.350 of 2008:-

38. The substantial question of law, which has been framed for consideration in the instant case, is whether the Tribunal is right in law in excluding the following from income eligible for deduction under Section 80IB:-

- (i) Interest from deposit with Tamil Nadu Electricity Board; and
- (ii) Interest received from housing and vehicle loans advanced to its employees.

39. The learned counsel for the assessee requested the Court to frame an additional substantial question of law with regard to the interest received on advances paid to suppliers.

40. We find that this issue was contested by the assessee and appears to have been inadvertently omitted while framing the substantial question of law when the appeal was lodged. Accordingly, we re-frame the substantial questions

of law as hereunder:-

“(a) Whether on the facts and in the circumstances of the case, the interest received from the employees and paid over to the HDFC on account of the loan availed by the employees from HDFC is income in the hands of the appellant and whether the same if treated as income is not eligible for relief under Section 80IB?”.

“(b) Whether on facts and in the circumstances of the case, the Income Tax Appellate Tribunal is right in law in holding that interest received on advances paid to suppliers cannot form part of business income for the purpose of deduction u/s.80IA of the Income Tax Act ?”

41. The Assessing Officer held that interest from housing and vehicle loan has no nexus to the business of the assessee and hence, immediate and effective source is not the business of the undertaking (the assessee). Accordingly, the Assessing Officer excluded these receipts from the profit of the assessee in computing the deduction under Section 80IB (in certain places in the order, it has been mentioned as Section 80IA and it should be read as 80IB).

42. The assessee filed an appeal before the CIT(A), which was partly allowed. However, the order passed by the Assessing Officer on the above heads was confirmed. The assessee filed appeal before the Tribunal, which was dismissed largely placing reliance upon the decision of this Court in **Madras Motors Ltd.** (supra). The assessee, aggrieved by such order, is on appeal against the same before us.

43. The CIT(A) while rejecting the contention of the assessee held that

advances made to the suppliers before the due date entitles the assessee to get discount from the creditors and this is directly related with the business activity of the assessee and as per accounting practice, discount is directly credited to the P & L account or netted against the cost of material and the Assessing Officer was directed not to exclude the sum of Rs.11.99 Lakhs from the eligible profit under this head while computing deduction under Section 80IB.

44. With regard to interest on housing loans and vehicle loans advanced to employees, the CIT(A) held that interest income should be treated as business income and by referring to the business of the assessee, it was held that earning interest is not its business and such interest on loans cannot be stated to be derived from manufacture of the industrial undertaking. Thus, by relying on the decision in the case of **Pandian Chemicals** (supra), the assessee's case was rejected.

45. The learned counsel appearing for the assessee relied on the decision of this Court in the case of **Arul Mariammal Textiles Limited vs. The Assistant Commissioner of Income Tax** [T.C.A.No.909 of 2008: Dated 07.08.2018] and submitted that whatever income accrued is merely incidental and not the prime purpose of doing the act in question.

46. The Revenue placed reliance on the decision of the Hon'ble Apex Court in the case of **Commissioner of Income Tax vs. Sterling Foods [(1999) 104 Taxman 204 (SC)]**.

47. In **Sterling Foods** (supra), it was held that income from selling import entitlement was not profits and gains from the industrial undertaking and it formed part of income and the same has to be included in the working out of the relief under 80HH.

48. In **Liberty India vs. Commissioner of Income-tax [(2009) 183 Taxman 349 (SC)]**, the assessee claimed deduction under Section 80IB on the increased profits earned/derived on account of Duty Entitlement Passbook (DEPB) Scheme and Duty Drawback Scheme. The Assessing Officer denied the deduction on the ground that the said two benefits constituted export incentives and that they did not represent profits derived from an industrial undertaking. We have to consider as to what would be the appropriate test.

49. In **Madras Motors Ltd.** (supra), the Division Bench held that the true test would be whether such interest would be available to the assessee otherwise also, as in the said case, the assessee earned interest on belated payments from purchase of products and if the answer to the question is in the negative, the assessee would be entitled for the deduction. Admittedly, the assessee does not carry on the business of financing for housing loan and or for vehicles. The benefit/concession is extended to the employees of the assessee as a part of a labour welfare package.

50. It is not disputed by the Revenue that the assessee borrows amounts from the bank at a higher rate of interest and extends housing and vehicle loans to its employees at subsidised rates. Thus, these loans and advances being incentives to the employees, has to be held to be directly relatable to the interest of industrial undertaking.

51. With regard to the advances paid to the suppliers, the CIT(A) was of the view that the assessee would get a discount on account of payment of such advances. On the other hand, the assessee has been able to establish that on account of payment of advances, the supplies are done promptly, which is directly relatable to the business of the industrial undertaking. Furthermore, it is also a commercially prudent decision to enable the industrial undertaking to efficiently function to generate better returns.

52. In **Arul Mariammal Textiles Limited** (supra), we had an occasion to consider similar issue and after taking note of several decisions on the point, decided the question in favour of the assessee holding that the interest income earned by the assessee is merely incidental and not the prime purpose of doing the act in question. In this regard, it would be useful to take note of the operative portions of the judgment, which read as follows:-

"10. As may be seen from the impugned order passed by the Tribunal, the Tribunal reiterated its earlier order dated 17.03.2006, wherein, the Revenue's appeal was allowed and even at that stage, the Assessee did not appear before the Tribunal. The Tribunal followed the decision in Pandian Chemical's case and held that the Assessee is

not entitled for deduction under Section 80 IA of the Act. The application filed by the Assessee to recall the said order was allowed and the Tribunal afforded one more opportunity to the Assessee. Nevertheless, the Assessee appeared before the Tribunal and sought for adjournment, which in the opinion of the Tribunal was a delaying tactics and accordingly, it reiterated its order dated 17.03.2006 and held that the interest earned from bank deposit for the purpose of margin money do not qualify for deduction. In other words, it is held that Pandian Chemical's case will hold the field and accordingly, allowed the Revenue's appeal.

11. Thus, we are first required to examine as to whether the decision in Pandian Chemical's case would apply to the facts and circumstances of the case. In preceding paragraphs, we have referred to the factual position of the Assessee's case. The margin money by way of fixed deposit was available with the Assessee's bankers so as to enable the Bank to open a Foreign Letter of Credit, which was essential for the purpose of import of critical components for the purpose of manufacture of the wind mill for generation of electricity.

12. Firstly, we note that the case of Pandian Chemical's arose out of a claim under Section 80HH of the Act. The Assessee therein had made deposits with the Tamil Nadu Electricity Board, which had earned interest. The question arose was whether interest on deposits with the Tamil Nadu Electricity Board should be treated as income derived on the part of the industrial undertaking for the purpose of Section 80HH of the Act?

13. The Supreme Court referred to the decision of the Privy Council in the case of CIT V. Raja Bahadu Kamakhaya Narayan Singh, (1948) 16 ITR 325 (PC), and held that the although electricity may be required for the purposes of an industrial undertaking, the deposit required for its supply is a step removed from the business of the industrial undertaking and the derivation of profits on deposits made with the Electricity Board cannot be said to flow directly from the industrial undertaking itself.

14. Firstly, we note that Section 80I, 80IA and 80IB have a common scheme and from the reading of those Sections it is clear that

the said sections provide for incentive in the form of deduction(s), which are linked to the profits and not to investment, whereas, in the other provisions, namely, Sections 80H, 80HH, 80HHA, 80HHB, 80HHBA and 80HHC, the scheme is different. In fact, this distinction was noticed by a Division Bench of the Kerala High Court in K.Ravindranathan Nair V. DCIT, (2003) 262 ITR 669 (Ker), wherein, the Court, while considering the decision of the Hon'ble Apex Court in Karnal Co-operative Sugar Mills Limited, pointed out that the said decision was not rendered in the context of all the provisions of Section 80HHC of the Act, as the decision in Karnal Co-operative Sugar Mills Limited followed the decision in the case of CIT V. Bokaro Steels Limited, (1999) 236 ITR 315 (SC). In Karnal Cooperative Sugar Mills Limited, the deposit of money was directly linked with the purchase of plant and machinery and therefore, it was held that any income earned on such deposit was incidental to the acquisition of assets for the setting up of plant and machinery. Therefore, in our view, the Tribunal committed an error in allowing the Revenue's appeal by merely placing reliance on the decision in the case of Pandian Chemical's, which arose out of a case under Section 80HH of the Act and this error committed by the Tribunal goes to the root of the matter affecting the very correctness of the order passed by the Tribunal.

15. In the case of CIT V. M/s.T.T.G. Industries Limited, 2012 SCC Online 1691, the question arose was whether the service charges for maintenance, charges for transportation, etc., to be included as profits and gains of an industrial undertaking for the purpose of computation of deduction under Section 80IA of the Act. The Court, after taking note of the decision in the case of Liberty India, pointed out that Section 80IA/80IB of the Act, has a common scheme and a reading of Section 80IA makes it clear that the only requirement for the applicability is deriving of income by an undertaking or an enterprise from any business referred to in sub section (4) and thus, any profits and gains derived from an industrial undertaking from any business would qualify for deduction under Section 80IA of the Act. In our view, the decision rendered in the case of T.T.G. Industries Limited

would squarely apply to the case on hand.

16. In the case of *Priviera Home Furnishing V. Additional CIT*, (2016) 237 Taxmann 520 (Delhi), the Assessee has stated that the interest on Fixed Deposit Receipts was received as margin money kept in the bank for utilization of Letter of Credit and Bank Guarantee limits and the Court held that the decision of the Tribunal that such interest bears the requisite characteristic of business income and has nexus to the business activities of the assessee cannot be faulted with. This decision also supports the case of the Assessee.

17. Equally, the decision in the case of *CIT V. Shah Alloys Limited*, (2017) 396 ITR 0711 (Guj), where, the Assessee had deposited money to open a Letter of Credit for the purchase of the machinery required for setting up its plant in terms of the agreement with the supplier and the money so deposited earned some interest, which was claimed as deduction. The Court held that it is not the case, where, any surplus share capital money, which is lying idle has been deposited in the bank for the purpose of earning interest and the deposit of money is directly linked with the purchase of plant and machinery. Accordingly, the Court answered the question in favour of the Assessee.

18. In the case of *CIT V. Shree Rama Multi Tech Limited*, 2018 SCC Online SC 433, the Court, after taking note of various decisions including that of *Bokaro Steel Limited* and *Karnal Cooperative Sugar Mills Limited*, held as follows :

"12. The common rationale that is followed in all these judgement is that if there is any surplus money which is lying idle and it has been deposited in the bank for the purpose of earning interest then it is liable to be taxed as income from other sources but if the income accrued is merely incidental and not the prime purpose of doing the act in question which resulted into accrual of some additional income then the income is not liable to be assessed and is eligible to be claimed as deduction. Putting the above rationale in terms of the present case, if the share application

money that is received is deposited in the bank in light of the statutory mandatory requirement then the accrued interest is not liable to be taxed and is eligible for deduction against the public issue expenses. The issue of share relates to capital structure of the company and hence expenses incurred in connection with the issue of shares are to be capitalized because the purpose of such deposit is not to make some additional income but to comply with the statutory requirement, and interest accrued on such deposit is merely incidental. In the present case, the responsibilities was statutorily required to keep the share application money in the bank till the allotment of shares was complete. In that sense, we are of the view that the High Court was right in holding that the interest accrued to such deposit of money in the bank is liable to be set-off against the public issue expenses that the company has incurred as the interest earned was inextricably linked with requirement of the company to raise share capital and was thus adjustable towards the expenditure involved for the share issue."

19. In the above referred decision, the Court analysed the purpose of deposit and held that it was not for some additional income, but to comply with the statutory requirements and the interest accrued on such deposit is merely incidental. In our considered view, this will be the right test to be applied to the case on hand and essentially, the answer to the substantial question should be in favour of the Assessee.

20. In the case of CIT V. Jaypee DSC Ventures Ltd., CDJ 2011 DHC 308, the Court held that the deposit made by the Assessee was not the surplus money lying idle with it to earn interest, but it was the amount of interest earned from fixed deposit, which was kept in the bank for the purpose of furnishing the Bank Guarantee. In our view, this decision also will enure in favour of the Assessee.

21. Equally is the decision in the case of CIT V. Paramount Premises (P) Ltd., (1991) 190 ITR 259 (Bom), wherein, analysing the purpose, for which, the deposits were made by the Assessee and the

interest earned thereon, the Bombay High Court affirmed the view of the Tribunal to the effect that the entire interest earned from the business activity of the Assessee and did not arise out of any independent activity.

22. The sheet-anchor of the submission of the learned counsel for the Revenue is based on the decision of the High Court of Himachal Pradesh in Himachal Futuristic Communication Ltd. V. CIT, (2014) 42 taxmann.com 179 (HP). Firstly, we may point out that there were two types of transactions, one by way of margin money for the purpose of purchase of raw material and the other by furnishing Bank Guarantee for due performance of the contract of sale to manufacture of goods. The question arose as to whether the same cannot be treated as income derived from the business, as such. The Court referred to the decision of the Apex Court in Liberty India (supra) and culled out the legal principle evolved therein stating that the profit must be generated from the business activity or operational profits. No more or no less. In fact, in paragraph 4 of the decision, the Court pointed out that the interpretation of Section 80HHC of the Act was entirely different, as it was a self-contained Code by itself. However, so far as the facts of the said case are concerned, the Court held that the expenditure incurred cannot be treated as a first source of income, which is the quintessence for attracting the benefit and incentive provided under Section 80IA of the Act. It was found that the monies, which were given by the Assessee, were towards performance guarantee and certain margin money for purchasing raw material. The Court, however, has not elaborated upon the facts of the decision of the Hon'ble Apex Court in Karnal Co-operative Sugar Mills Limited (supra) and Bokaro Steel Limited (supra) and on facts, we find that the said decision of the High Court of Himachal Pradesh cannot be applied to the facts and circumstances of the case on hand.

23. So far as the decision in the case of Liberty India (supra) is concerned, the same would not apply to the facts of present case, because the said decision arose out of a drawback incentive, which was on account of a scheme framed by the Central Government and the Court held that the incentive profits are not profits derived from

eligible business under Section 80IB of the Act and they belong to the category of ancillary profits of such undertakings. Therefore, on facts, learned counsel for the Revenue cannot place reliance on the case of Liberty India (supra) to deny the benefit to the Assessee.

24. So far as the decision in the case of Cyber Pearl IT Park Limited, the Court, after taking into consideration various decisions, pointed out that in order to come to a conclusion as to whether such profits or gains, that is, income would be amenable to deduction, the effective source of income is to be looked at. Thus, essential factual matrix needs to be looked to arrive at a conclusion as to the effective source from which such income earned and if it is found that it is derived from secondary source, it is not the effective source, which falls outside the purview of such like provision, which provides for deduction.

25. In the instant case, the requirement of the Assessee to furnish the fixed deposit was a pre-condition to enable the Assessee to open a foreign Letter of Credit for the purpose of import of critical components for the manufacture of wind mill. This incidentally had earned some interest. As pointed out by the Hon'ble Supreme Court in Shree Rama Multi Tech Limited, it is not the Assessee's surplus money, which was deposited by way of fixed deposit, which had earned interest ; on the contrary, it was a pre-condition for the purchaser/Assessee to enable him to import the critical component for the purpose of manufacturing. Furthermore, it is not the case of the Revenue that the amount was deposited in fixed deposit solely for the purpose of earning interest nor it is the case of the Revenue that the amount, which was deposited in fixed deposit was a surplus money, which was lying idle in the hands of the Assessee. Therefore, whatever income accrued is merely incidental and not the prime purpose of doing the act in question, which resulted into accrual of some additional income and therefore, the said income is not liable to be assessed and is eligible to be claimed as deduction."

53. In the light of the above discussion, we are of the considered view that the substantial questions of law framed for consideration have to be answered in favour of the assessee. Accordingly, the same are answered.

54. In the result, T.C.(A) Nos.349 and 350 of 2008 are allowed and the substantial questions of law are answered in favour of the appellant/assessee. No costs.

(T.S.S., J.) (V.B.S., J.)

02.11.2018

gg/abr

To

The Assistant Commissioner of Income Tax,
Company Circle II(3),
121, Nungambakkam High Road,
Chennai-600 034.

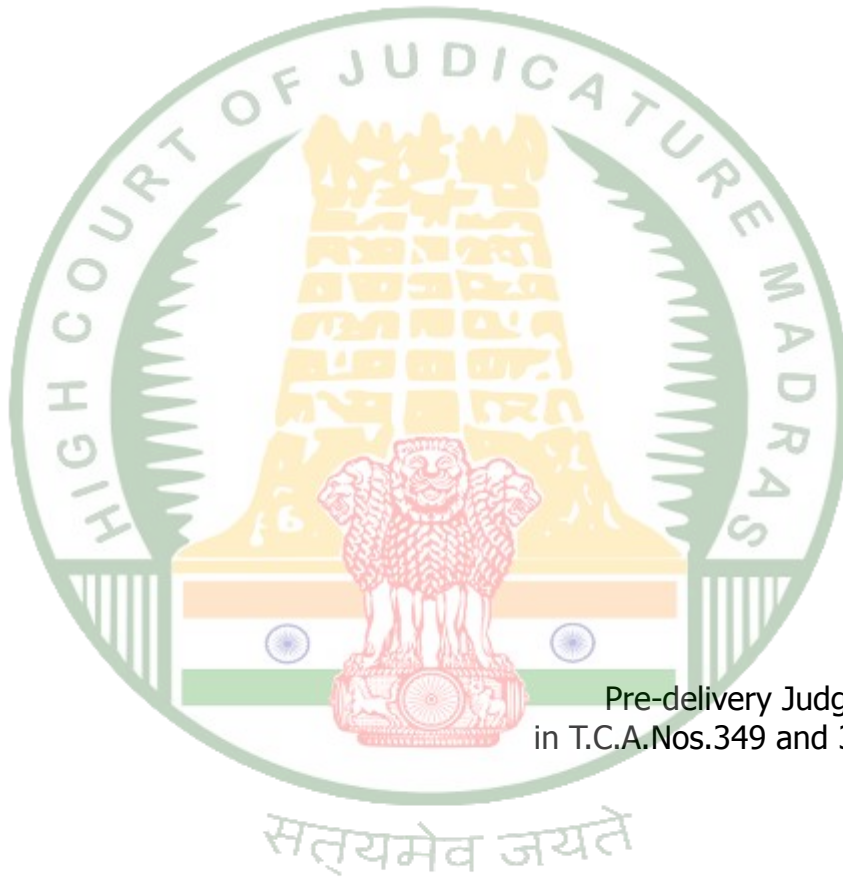
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T.S.Sivagnanam, J.

and

V.Bhavani Subbaroyan, J.

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Pre-delivery Judgment made
in T.C.A.Nos.349 and 350 of 2008

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