IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 23.07.2019

Judgment Reserved On 15.07.2019	Judgment Pronounced On 23.07.2019

CORAM:

THE HONOURABLE MR.JUSTICE T.S.SIVAGNANAM
and
THE HONOURABLE MRS.JUSTICE V.BHAVANI SUBBAROYAN

Tax Case (Appeal) No.2079 of 2008

JVS Exports,
32, Sarojini Street,
Madurai-625 002. .. Appellant/Appellant

-vs-

Asst. Commissioner of Income-tax,
Circle-I, Madurai. .. Respondent/Respondent

APPEAL under Section 260A of the Income-tax Act, 1961, against the order dated 29.09.2008 on the file of the Income-tax Appellate Tribunal Bench 'B', Chennai in I.T.A.No.1741/Mds/2007 for the assessment year 2004-05. against the Order of the Commissioner of Income Tax (Appeals)-1, Madurai dated 21.03.2007 in ITA.No.0317/06-07 and against the order of the Assistant Commissioner of Income Tax Circle-I, Madurai dated 27.12.2006 and made in AABFJ 2836N.

For Appellant : Mr.R.Srinivasan

For Respondent : Ms.R.Premalatha,
Junior Standing Counsel
assisted by

: Mr.M.Swaminathan,
Senior Standing Counsel

JUDGMENT

T.S.Sivagnanam, J.

This appeal, filed by the appellant/assessee under Section 260A of the Income-tax Act, 1961 (hereinafter referred to as “the Act”), is directed against the order dated 29.09.2008, passed by the Income-tax Appellate Tribunal Bench 'B', Chennai ("the Tribunal", for brevity) in I.T.A.No.1741/Mds/2007, for the assessment year 2004-05.

2.The above appeal has been admitted, on 23.06.2009, on the following substantial question of law:-

> "Whether on the facts and in the circumstances of the case the Tribunal is right in holding that interest income assessed as "business income" is to be excluded from the 'profits and gains of business" for purposes of Section 80HHC and if so whether the gross or net interest is excludable?"

3.The assessee is a firm engaged in the business of manufacture, sale and export of handloom towels and other items. The assessee filed its return of income for the assessment year under consideration (2004-05), on 11.10.2004, declaring a total income of Rs.1,67,29,196/-, which was processed under Section 143(1) of the Act, on 23.02.2005. The case was selected for scrutiny and after hearing the assessee's authorised representative, the assessment was finalized under Section 143 (3) of the Act, on 27.12.2006, determining the total income at Rs.3,01,57,640/-.

4.The assessee filed appeal before the Commissioner of Income-tax (Appeals)-I, Madurai (for brevity, "the CIT(A)"), contending that the Assessing Officer has included sales tax and excise duty as part of total turnover for the purposes of working out the eligible deduction under Section 80HHC of the Act contrary to the facts, as there was no such collection in the assessee's case. It was further contended that the Assessing Officer has excluded gross interest receipts assessed under the head "profits and gains of business" which has a nexus with the export activity and which has been netted by the assessee. Further, the Assessing Officer has denied relief under Section 80HHC of the Act in respect of export incentives like DEPB without appreciating the law and facts of the case while the assessee has incurred a loss on its transfer. It was further contended that the Assessing Officer has included quota sales which were wrongly admitted as coming under Section 28 (iiia) to 28(iiic) while excluding items under Clause (baa) under Explanation to Section 80HHC. With the above, the Assessing Officer has computed a total turnover, which is not reconcilable with the figures submitted in this regard.

5.Before the CIT(A), it was argued that the Assessing Officer erred in not netting the interest receipts and interest payments especially when both have a nexus with the export activity. The Assessing Officer failed to note that such a netting has been upheld by the Tribunal in Lalsons Enterprises vs. DCIT reported in [2004] 89 ITD 25 (SB) Delhi and explained in DCIT vs. Paramount Trading Corporation reported in [2006] 98 ITD 77 (TM) Delhi. The decisions relied on by the Assessing Officer were distinguished as being inapplicable to the facts of the assessee's case. The assessee placing reliance on the decision in CIT vs. A.S.Nizar Ahmed & Co., reported in [2003] 259 ITR 244 (Mad.), contended that in the said decision, it has been held that where there is a link with the export business, interest has to be netted.

6.With regard to the first ground, viz., against inclusion of sales tax and excise duty as part of total turnover for the purpose of computation of deduction under Section 80HHC, the assessee succeeded before the CIT(A).

6.1. With regard to the second ground, against not netting the interest receipts and interest payments while computing deduction under Section 80HHC, the CIT(A) applied the decision in the case of CIT vs. Chinnapandi reported in [2006] 201 CTR 13 (Mad.) and rejected the contention of the assessee.

6.2. The third ground with regard to the decision of the Assessing Officer adopting the entire sale proceeds of DEPB for the purpose of application of sub-Section (baa) to Explanation to Section 80HHC, the CIT(A) allowed the assessee's case and directed the Assessing Officer to modify the computation, accordingly.

7.Thus, the assessee is before us only with regard to the issue whether the Tribunal is right in holding that interest income assessed as business income is to be excluded from the "profits and gains of business" for purposes of Section 80HHC and if so whether gross or net interest is excludable.

8.Before the Tribunal, the assessee contended that the interest earned bears direct nexus with the business of the assessee and it should be treated as business income. Further, only net interest is to be considered, since in the assessee's case, no interest was negative figure and no amount should be considered for exclusionary purpose.

9.The Tribunal applied the decision in the case of Dollar Apparels vs. ITO reported in [2007] 294 ITR 484 (Mad.) and held that interest on deposit is not entitled for special deduction under Section 80HHC, as it bears no nexus with the export earning.

10.Mr.R.Srinivasan, learned counsel appearing for the assessee contended that the Tribunal ought to have noted that since the deposit made with the bank is obligatory in terms of the certificate issued by the bank, the interest income has to be treated as a business income and the decision in the case of

A.S.Nizar Ahmed & Co. (supra) ought to have been applied by the Tribunal. In support of his contention, the learned counsel placed reliance on the decisions in CIT vs. Bangalore Clothing Co., reported in [2003] 260 ITR 371 (Bom.);

CIT And Anr. vs. Motor Industries Co. Ltd., reported in [2011] 331 ITR 79 (Kar.);

Aurobindo Pharma Ltd., vs. CIT reported in [2015] 370 ITR 216 (T&AP);

CIT vs. TTK LIG Ltd., reported in [2018] 409 ITR 390 (Mad.);

CIT vs. Abdul Rahman Industries reported in [2007] 293 ITR 475 (Mad.); and

Arul Mariammal Textiles Ltd., vs. Assistant Commissioner of Income-tax, Coimbatore reported in [2018] 97 taxmann.com 298 (Mad.).

11.Ms.S.Premalatha, learned Junior Standing Counsel, assisted by Mr.M.Swaminathan, learned Senior Standing for the Revenue sought to sustain the order passed by the Tribunal by placing reliance on the decisions in Rani Paliwal vs. CIT reported in [2004] 136 Taxman 135 (Punj. & Har.);

CIT vs. Liberty Footwear Co., reported in [2006] 287 ITR 339 (Pun. & Har.); and

K.S.Subbiah Pillai & Co. (India) (P.) Ltd., vs. CIT reported in [2004] 134 Taxman 735 (Mad.).

12.Alternatively, it was submitted that facts need to be examined in an appropriate manner and for which purpose, the Court may remand the matter for fresh consideration as was done in the case of CIT vs. M/s.Rane Engine Valves Ltd. [T.C.A.No.1168 of 2008, dated 19.11.2018].

13.Before the assessing Officer, the assessee contended that all deposits made with the bank were from and out of the export sale proceeds, deposits were made for availing the working capital loan from Central Bank of India, all the deposits were marked as collateral security and in the course of export business, which is the only business of the assessee, it availed loans and paid interest and while paying interest on the loans taken for the export business, the interest on these deposits are to be reckoned and the net only is the interest to be effectively paid on the loans obtained. This argument of the assessee was not accepted by the Assessing Officer on the ground that any income to be called as business income and to qualify for deduction under Section 80HHC, should have direct nexus with export activity and even though the Fixed Deposits were kept for business and the interest is in the nature of receipt, it does not qualify to be called business income.

14.The learned counsel for the assessee has drawn the attention of this Court to a letter dated 10.03.2006, addressed by the Central Bank of India to the assessee stating that they are advancing loans to the assessee for their export business and to ensure the safety of advances, the bank diverts some of the export sale proceeds on realisation towards Fixed Deposits in the name of the assessee being additional security for the loan as has been the practice right from the beginning.

15.The question would be as to whether this interest has any direct nexus to the business activity of the assessee, viz., exports.

16.In Bangalore Clothing Co. (supra), similar issue arose for consideration and the Court held that the Department cannot invoke Explanation (baa) in every matter involving receipts by way of brokerage, commission, interest, rent, labour charges, etc., and these items of income have to be seen in the context of the business activity of the assessee. It was pointed out that the Assessing Officer will have to ascertain whether the receipt of interest, commission, labour charges, etc., were a part of operational income. It was further pointed out that the Court cannot lay down any standard test for deciding what would constitute operational income and the Department will have to consider the memorandum of articles of association of company, the nature of the business, the nature of the activity and such other tests. Further, the Department will also have to ascertain as to what is the dominant business of the company and whether receipts like interest, commission, etc., accrue as a part of the main business activity or whether they accrue out of incidental business. In the said case, the Tribunal, on facts, found that the job processing activity done by the assessee was linked to the manufacturing activity and affirmed the finding of the Tribunal holding that 90 per cent of labour charges ought not have been excluded from such business profits while computing deduction under Section 80HHC.

17.In Motor Industries Co. Ltd. (supra), the substantial question of law which was considered was whether the income received by the assessee towards developmental work in the course of its export business which is different from the income arising out of the business of export out of India of any goods are merchandise is liable to be reduced by 9 per cent as provided under Clause (1) of Explanation (baa) to Section 80HHC of the Act. It was held that in computing the profits of the business for the purpose of Explanation (baa), the incomes which are deductible are those which are expressly prescribed in the aforesaid provision and which are similar in nature. It was further held that if the income is derived out of the activity which would have direct and immediate nexus to the activity of export, then such income is not deductible from the said profits of the business under the aforesaid provisions. It was pointed out that the expression “any other receipt of a similar nature” has to be understood in the context of the words proceeding the said expression, viz., “brokerage”, “commission”, “interest”, “rent” or “charges”, such receipts have no nexus with the income earned by way of foreign exchange. It was further pointed out that every receipt is not income and every income would not necessarily include element of export turnover. Thus, the basic requirement of Section 80HHC is earning in foreign exchange and retention of profits for export business and such benefit should go only exporters and should not be misused in getting the benefit when there is no element of export involved in the income. In the said case, on facts, it was found that the assessee is in the business of export of goods and merchandise, the assessee was earning foreign exchange our of that export and the disputed income is earned by the assessee for its fees towards development work and the developmental work is intimately connected with the business of manufacture and sale of goods by the assessee and there is immediate nexus between the activity of export and the developmental work. Thus, it was held that the Tribunal was justified in holding that the said consideration received for developmental work is not liable to be deduced under Clause (baa) in computing the profits of the business.

18.Similar view was taken in Aurobindo Pharma Ltd. (supra) by placing reliance on the decision in Bangalore Clothing Co. (supra).

19.In TTK LIG Ltd. (supra), it was held that the Tribunal was right in holding that exchange fluctuation, provision written back should be treated as income derived out of business for computation of deduction under Section 80HHC.

20.In Abdul Rahman Industries (supra), the substantial question of law, which fell for consideration was whether the assessee was entitled to deduction under Section 80HHC in respect of a sum being unclaimed balances written back in the profit and loss account. The case was decided in favour of the assessee holding that there were credits appearing in the books on the basis of purchase of items from various suppliers and these suppliers were not paid and these unclaimed credit balances were brought to the profit and loss account and had emanated from trading transactions only and the transactions were connected or closely linked with the assessee's business activities and the receipts had arisen only out of ordinary trading transactions and hence were rightly assessed under the head “Business” and the assessee was entitled to the benefit under Section 80HHC.

21.In Arul Mariammal Textiles Ltd. (supra), it was held that interest on margin money by way of Fixed Deposit kept with the assessee's banker so as to enable the bank to open a foreign letter of credit which was essential for purpose of import of critical components for carrying on business of the assessee was eligible for deduction under Section 80-IA.

22.As pointed out by us earlier, the bank from which the assessee availed loans for their export business, in no uncertain terms had mentioned that from and out of the export sale proceeds, they (bank) would divert some of it upon realisation of the sale proceeds towards Fixed Deposits in the name of the assessee being additional security for the loans. Thus, it is seen that the conversion of a portion of the export sale proceeds on realisation as Fixed Deposits was not on the volition of the assessee, but by a unilateral act of the bank over which, the assessee had no control. Furthermore, the bank had made it explicitly clear that the Fixed Deposits are created for being treated as additional security for the loans availed by the assessee. The Revenue does not dispute the fact that the loans availed by the assessee was for their export business.

23.In such circumstances, there can be no dispute to the fact that these receipts have a direct and immediate nexus to the activity of export done by the assessee and in such circumstances, the said income is not deductible from the said profits of business. The Revenue cannot dispute the immediate nexus between the activity of export and the creation of Fixed Deposits to be retained by the bank as additional security towards the loan availed for the export business.

24.In Rani Paliwal (supra), relied on by the Revenue, the question was whether the Tribunal was legally correct in holding that the claim for deduction in respect of income from Fixed Deposit Receipts (FDRs) was not substantial, despite contrary and consistent view having been expressed by the Bombay High Court in the cases of CIT vs. Paramount Premises (P.) Ltd., reported in [1991] 190 ITR 259 (Bom); and CIT vs. Nagpur Engg. Co. Ltd., reported in [2000] 245 ITR 806 against which, the Special Leave Petition of the Department was dismissed.

25.On perusing the judgment, we find the issue before the Tribunal in the said case was not as to whether the interest income received from the Fixed Deposits had any bearing on the business of the assessee. In any event, the appeal filed by the assessee was dismissed on the ground that there is no substantial question of law arising in the appeal. Therefore, this decision cannot be cited as a precedent by the Revenue.

26.The decision in the case of Rani Paliwal (supra) was followed in Liberty Footwear Co. (supra) and on facts, it was found that in the said case also, there is no contention placed before the Court as to whether the interest income had direct nexus with the business activity of the assessee.

27.In Rane Engine Valves Ltd. (supra), the Court while considering as to whether the deposits made by the assessee with the banks had an immediate nexus with the business of the assessee, found that the facts were not placed before the Court and therefore, opined that the matter requires to be re-adjudicated afresh for which purpose, the matter was remanded to the Assessing Officer to take a fresh look into the matter.

28.As pointed out by us earlier, the facts of the case are vividly clear and the Fixed Deposits have been created by the bank themselves by carving out a portion of the export sale proceeds on realisation and retaining them as Fixed Deposits in the name of the assessee to be retained by the bank as additional security for the loan availed by the assessee for their export business.

29.As mentioned earlier, the conversion of a portion of the sale proceeds as Fixed Deposits was done by the bank themselves and not on the volition of the assessee. Therefore, we are fully convinced that the transaction was connected and closely linked with the assessee's business activity.

30.Thus, we hold that the Tribunal erred in dismissing the assessee's appeal.

31.For the above reasons, the appeal filed by the assessee is allowed and the substantial question of law is answered in favour of the assessee. No costs.

Sd/-
Assistant Registrar(CS VIII)

//True Copy//

Sub Assistant Registrar

abr

To

1. The Assistant Commissioner of Income-tax,
   Circle-I(i/c), Madurai.
2. The Commissioner of Income-tax (Appeals)-I, Madurai.
3. The Income-tax Appellate Tribunal Bench 'B', Chennai.

+1cc to Mr.R.Srinivasan, Advocate, S.R.No.62822
+1cc to Mr.M.Swaminathan, Advocate, S.R.No.62676

Tax Case (Appeal) No.2079 of 2008

MP(CO)
CS/17/09/2019