IN THE HIGH COURT OF HIMACHAL PRADESH, SHIMLA

ITA No.31 of 2007 along with
ITA Nos.32 & 33 of 2007

Date of decision: 30.11.2009.

Shri Virender Kumar Walia (in all cases) **….Appellant**

Versus

Assistant Commissioner of Income Tax (in all cases) **…..Respondent**

Coram:

The Hon'ble Mr. Justice Deepak Gupta, Judge.

The Hon'ble Mr. Justice V.K.Ahuja, Judge.

Whether approved for reporting?[1] No

For the Appellant(s).: ***Mr.K.D. Sood, Advocate.***

For the Respondent: **Mr.Vinay Kuthiala & Mrs.Vandana Kuthiala, Advocates.**

Deepak Gupta, J.(oral)

These appeals are being disposed of by a single judgment as the questions of law involved in all the appeals are the same and read as follows:

> "1.Whether on a proper interpretation of Section 80IA of the Income Tax Act and the Income Tax Appellate Tribunal, Chandigarh was justified in holding that the freight subsidy granted to the assessee is not to be adjusted against the freight paid by the assessee and the said amount is not to be taken into account in working out the profit and gain derived from the industrial undertaking?
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> 2.Whether in the facts and circumstances of the case and taking into account the totality of the case into consideration, the grant of transport subsidy was to recoup the expenses to be taken into account in computation of deduction under Section 890 IA?
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> 3.Whether the Income Tax Appellate Tribunal, Chandigarh could ignore the binding precedents of the Income Tax

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[1] ***Whether the reporters of the local papers may be allowed to see the Judgment? yes***

Appellate Tribunal, Chandigarh itself in various cases wherein the points had been decided in favour of the assessee and the appeals of the department are pending in this Hon'ble Court, particularly, ITA No.1 of 2005 CIT versus M/s.Kiran Enterprises as also ITA No.65 of 2006, 66 of 2006, 67 of 2006 and 68 of 2006 CIT vs. Associated Minerals Industries and others pending in the High Court of Himachal Pradesh which had followed the decision of the Gujarat High Court in 275 ITR 284 and 246 ITR 97?"

Section 80-1A of the Income Tax Act, 1961 (hereinafter referred to as the Act) reads as follows:

"80-1A. Deduction in respect of profits and gains from industrial undertakings, etc., in certain cases.- (1)where the gross total income of an assessee includes any profits and gains derived from any business of an industrial undertaking or a hotel or operation of a ship or developing, maintaining and operating any infrastructure facility or scientific and industrial research and development or providing telecommunication services whether basic or cellular including radio paging, domestic satellite service or network of trunking and electronic data interchange services or construction and development of housing projects or operating an industrial park or commercial production or refining of mineral oil in the North Eastern Region or in any part of India on or after the 1st day of April, 1997 (such business being hereinafter referred to as the eligible business), to which this section applies, there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction from such profits and gains of an amount equal to the percentage specified in sub-section (5) and for such number of assessment years as is specified in sub-section (6).

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(5)The amount referred to in sub-section (1) shall be—

(i)(a)in the case of an industrial undertaking referred to in sub-clause (a) or sub-clause(d) of clause (iv) of sub-

section(2), twenty-five per cent of the profits and gains derived from such industrial undertakings;

(b)in the case of an industrial undertaking referred to in sub-clause (b) or sub clause (c) of clause (iv) of sub-section (2), hundred per cent of the profits and gains derived from such industrial undertaking for the initial five assessment years and thereafter twenty-five per cent of the profits and gains derived from such industrial undertaking.

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(7)Notwithstanding anything contained in any other provision of this Act, the profits and gains of an eligible business to which the provisions of sub-section (1) apply shall, for the purposes of determining the quantum of deduction under sub-section (5) for the assessment year immediately succeeding the initial assessment year or any subsequent assessment year, be computed as if such eligible business were the only source of income of the assessee during the previous year relevant to the initial assessment year and to every subsequent assessment year up to and including the assessment year for which the determination is to be made."

It would not be out of place to mention that after the amendment made in Section 80-1A by the Finance Act, 1999 w.e.f. 1.4.2000, Section 80-1A was split into two parts and now Section 80-1A applies to undertakings and enterprises engaged in infrastructure development and Section 80-1B applies to other eligible business. The provisions of Section 80-1B are paramateria with Section 80-1A as they previously existed.

In the State of Himachal Pradesh there is scarcity of rail net work. A scheme has been framed by the Central Government whereby freight/transport subsidy is provided to the industries set-up in remote areas where

rail facilities are not available and some percentage of the transport expenses incurred by the industrial undertakings to transport raw material to the factory and to transport finished goods from their industries is subsidized by the Central Government. The question which arises is whether this freight subsidy is income derived from the business of the industrial undertaking and can be included in the profits eligible for deduction under Section 80-1A.

Learned counsel for the parties have cited a number of authorities before the Court. The basic authority on the point is **Cambay Electric Supply Industrial Co. Ltd. vs. Commissioner of Income-Tax, Gujarat-II, (1978) 113 ITR 84.** In that case the Apex Court was dealing with the provisions of Section 80-E of the Act prior to its amendment in 1967. The assessee was carrying on the business of generation and distribution of electricity. It sold out some of its machinery and building. The question which arose was whether the amount earned from the sale of the machines and buildings was attributable to the business of the Industry. The Apex court held as follows:

> "As regards the aspect emerging from the expression "attributable to" occurring in the phrase "profits and gains attributable to the business of" the specified industry (here generation and distribution of electricity) on which the learned Solicitor general relied, it will be pertinent to observe that the Legislature has deliberately used the expression "attributable to" and not the expression "derived from". It cannot be disputed that the expression "attributable to" is certainly wider in import than the expression "derived from". Had the expression 'derived from" been used

> it could have with some force been contended that a balancing charge arising from the sale of old machinery and buildings cannot be regarded as profits and gains derived from the conduct of the business of generation and distribution of electricity. In this connection it may be pointed out that whenever the Legislature wanted to give a restricted meaning in the manner suggested by the learned Solicitor General it has used the expression "derived from", as for instance in S. 80-J. In our view, since the expression of wider import, namely, "attributable to" has been used, the Legislature intended to cover receipts from sources other than the actual conduct of the business of generation and distribution of electricity."

Relying on these observations of the Apex court it is contended on behalf of the Revenue that since in Section 80-1A the word 'derived' has been used, the transport subsidy cannot be said to be derived from the business of the industrial undertakings.

A Division Bench of the Calcutta High Court dealt with a similar question in **Merinoply and Chemicals ltd. vs. Commissioner of Income-tax, (1994) 209 ITR 508.** One of the questions before the Calcutta High Court was whether transport subsidies were inseparably connected with the business carried on by the assessee or not. In that case 50% of the transportation cost of raw material and finished goods was paid to the new Units set up in the backward areas. The Court held as follows:

> "All in all, the payment of transport subsidies are meant to augment the profit and make the industry viable economically.
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> We do not find any perversity in the Tribunal's finding that the scheme of transport subsidies is inseparably connected with the business carried on by the assessee. It is a fact that the assessee was a manufacturer of plywood, it is also a fact that the

> assessee has its unit in a backward area and is entitled to the benefit of the scheme. Further is the fact that transport expenditure is an incidental expenditure of the assessee's business and it is that expenditure which the subsidy recoups and that the purpose of the recoupment is to make up possible profit deficit for operating in a backward area. Therefore, it is beyond all manner of doubt that the subsidies were inseparably connected with the profitable conduct of the business and in arriving at such a decision on the facts the Tribunal committed no error."

In **Ashok Leyland Ltd. vs. Commissioner of Income-Tax, (1997) 224 ITR 122,** the industry was carrying out a priority industry and the question which arose before the Apex Court was whether the profits and gains arising from the import and sale of spare parts can be said to be attributable to the priority industry. Relying upon the law laid down in **Cambay case** the Apex Court held that the word 'attributable' has a wide meaning and concluded that the profits from sale of imported spare parts were attributable to the priority industries.

In **Commissioner of Income-Tax vs. Pandian Chemicals Ltd., (1998) 233 ITR 497,** a Division Bench of the Madras High Court dealt with the question as to the gains eligible for deduction under Section 80HH of the Income Tax Act. In that case the assessee was required to make a deposit before the Electricity Board before power supply was given to it. The assessee earned interest on this deposit. The question was whether this deposit is an income derived from an

industrial undertaking to be eligible for relief under Section 80HH. After analyzing the entire case law the Madras High Court held as follows:

> "A study of various case laws clearly indicates that a restricted meaning is given when the Legislature uses the expression, "derived from". Though the assessee has necessarily to make the deposit with the Electricity Board for running the industry and the power supply will not be made without the deposit in favour of the Electricity Board, the income derived from the deposit with the Electricity Board cannot be said to have been derived from the industrial undertaking. The immediate source of interest is the deposit itself, and the effective source of the genealogy of the source of the interest income is the deposit and not business, as the industrial undertaking is removed by one step from the source of income for the interest. Hence, the interest income cannot be held to be derived from the industrial undertaking."

The Madras High Court had placed reliance on the judgment of the Karnataka High Court in **Sterling Foods vs. CIT, (1984) 150 ITR 292.** The judgment of the Karnataka High Court was upheld by the Apex Court in **Commissioner of Income-Tax vs. Sterling Foods, (1999)237 ITR 579.** In this case the assessee had sold the import entitlements and had thus derived profit. The question which arose was whether the receipts from the sale of import entitlements were eligible for relief under Section 80HH. The assessee was engaged in the business of processing prawns and other sea food which it exported. Due to export of items of its products it earned some import entitlements granted by the Central Government under the Export Promotion Scheme. The

assessee was entitled to use the import entitlements itself or sell the same to others. The assessee sold the import entitlements. The question before the Apex court was whether the amount received for sale of import entitlement was income derived from business. The Apex Court held as follows:

> "We do not think that the source of the import entitlements can be said to be the industrial undertaking of the assessee. The source of the import entitlements can, in the circumstances, only be said to be the Export Promotion Scheme of the Central Government where under the export entitlements become available. There must be, for the application of the words "derived from," a direct nexus between the profits and gains and the industrial undertaking. In the instant case the nexus is not direct but only incidental. The industrial undertaking exports processed sea food. By reason of such export, the Export Promotion Scheme applies. Thereunder, the assessee is entitled to import entitlements, which it can sell. The sale consideration there from cannot, in our view, be held to constitute a profit and gain derived from the assessees' industrial undertaking."

It is contended by Sh.Kuthiala that in the present case also the freight source of subsidy is the scheme framed by the Central Government and not the business of the industry and therefore the same cannot be said to be derived.

In **Commissioner of Income Tax vs. Andaman Timber Industries Ltd., (2000) 242 ITR 204,** the assessee had claimed the benefit of Section 80HH on profits and gains derived from the industrial undertaking and had included the amount paid to it under the transport subsidy scheme. The Calcutta High Court referred to the judgment of the Apex Court cited hereinabove and held that the transport subsidy is not derived from the activity

of the industrial undertaking though it may be attributable to it and therefore cannot be said to be treated as parts of the profits and gains derived from the industrial undertaking.

The relevant portion of the judgment reads as follows:

> "The limited question for our consideration is whether the amount of transport subsidy is a profit for the purpose of deduction under section 80HH of the Income-tax Act. As referred to above, their Lordships in their latest decision in the case of CIT v. Sterling Foods (1999)237 ITR 579 (SC), had made a distinction between the words "derived from" and "attributable to". The words "attributable to" have wider import than the words "derived from" and when the Legislature has used the words "derive from" in Section 80HH, we cannot enlarge the scope of benefit intended by the legislature in section 80HH. Profits and gains which are derived from an industrial undertaking are only eligible for deduction under section 80HH. Any incidental income or profit to the business of the assessee or to the income of the industrial undertaking is not entitled or eligible for the benefit of section 80HH. The industrial undertaking should be the direct and immediate source of income for the purpose of deduction under section 80HH. Subsidy or transport subsidy is not the immediate source or have direct nexus with the activity of the industrial undertaking. It is an aid by the Government under the Scheme. Though it is incidental to the activities of the assessee, the source is the Government. Any aid or assistance by the Government to a particular type of industry cannot be treated as profit derived from the industrial undertaking."

The Apex Court in **M/s.Liberty India vs. Commissioner of Income Tax, JT 2009 (11) SC 571,** after considering the legal provisions held as follows:

> "13. Before analyzing Section 80-IB, as a prefatory note, it needs to be mentioned that the 1961 Act broadly provides for two types of tax incentives, namely, investment linked incentives and profit linked incentives. Chapter VI-A which provides for incentives in the form of tax deductions essentially belong to the category of "profit linked incentives". Therefore, when Section 80-IA/80-IB refers to profits derived from eligible business, it is not the ownership of that business which attracts the incentives. What attracts the incentives under Section 80-IA/80-IB is the generation of profits (operational profits). For example, an assessee company located in Mumbai may have a business of building housing projects or a ship in Nava Sheva. Ownership of a ship per se will not attract Section 80-IB(6). It is the profits arising from the business of a ship which attracts sub-section (6). In other words, deduction under sub-section (6) at the specified rate has linkage to the profits derived from the shipping operations. This is what we mean in drawing the distinction between profit linked tax incentives and investment linked tax incentives. It is for this reason that Parliament has confined deduction to profits derived from eligible businesses mentioned in sub-sections (3) to (11A) [as they stood at the relevant time]. One more aspect needs to be highlighted. Each of the eligible business in sub-sections (3) to (11A) constitutes a stand-alone item in the matter of computation of profits. That is the reason why the concept of "Segment Reporting" stands introduced in the Indian Accounting Standards (IAS) by the Institute of Chartered Accountants of India (ICAI).
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> 14. Analyzing Chapter VI-A, we find that Sections 80-IB/80-IA are the Code by themselves as they contain both substantive as well as procedural provisions. Therefore, we need to examine what

these provisions prescribe for "computation of profits of the eligible business". It is evident that Section 80-IB provides for allowing of deduction in respect of profits and gains derived from the eligible business. The words "derived from" is narrower in connotation as compared to the words "attributable to". In other words, by using the expression "derived from", Parliament intended to cover sources not beyond the first degree. In the present batch of cases, the controversy which arises for determination is: whether the DEPB credit/ Duty drawback receipt comes within the first degree sources? According to the assessee(s), DEPB credit/duty drawback receipt reduces the value of purchases (cost neutralization), hence, it comes within first degree source as it increases the net profit proportionately. On the other hand, according to the Department, DEPB credit/duty drawback receipt do not come within first degree source as the said incentives flow from Incentive Schemes enacted by the Government of India or from Section 75 of the Customs Act, 1962. Hence, according to the Department, in the present cases, the first degree source is the incentive scheme/ provisions of the Customs Act. In this connection, Department places heavy reliance on the judgment of this Court in Sterling Food (supra). Therefore, in the present cases, in which we are required to examine the eligible business of an industrial undertaking, we need to trace the source of the profits to manufacture. (see CIT v. Kirloskar Oil Engines Ltd. reported in [1986] 157 ITR 762).

15. Continuing our analysis of Sections 80-IA/80-IB it may be mentioned that sub-section (13) of Section 80-IB provides for applicability of the provisions of sub-section (5) and sub-sections (7) to (12) of Section 80-IA, so far as may be, applicable to the eligible business under Section 80-IB. Therefore, at the outset, we stated that one needs to read Sections 80I, 80-IA and 80-IB as having a common Scheme. On perusal of sub-section(5) of Section 80-IA, it is noticed that it provides for manner of computation of profits of an eligible business. Accordingly, such profits are to

> be computed as if such eligible business is the only source of income of the assessee. Therefore, the devices adopted to reduce or inflate the profits of eligible business has got to be rejected in view of the overriding provisions of sub- section (5) of Section 80-IA, which are also required to be read into Section 80-IB. [see Section 80-IB(13)]. We may reiterate that Sections 80I, 80-IA and 80-IB have a common scheme and if so read it is clear that the said sections provide for incentives in the form of deduction(s) which are linked to profits and not to investment. On analysis of Sections 80-IA and 80-IB it becomes clear that any industrial undertaking, which becomes eligible on satisfying sub-section(2), would be entitled to deduction under sub-section (1) only to the extent of profits derived from such industrial undertaking after specified date(s). Hence, apart from eligibility, sub-section(1) purports to restrict the quantum of deduction to a specified percentage of profits. This is the importance of the words "derived from industrial undertaking" as against "profits attributable to industrial undertaking".

After the aforesaid detailed analysis, the Apex Court held that the duty draw backs could not be deemed to be profits derived from business. It is apparent that the Apex court held that it is only the profits generated i.e. operational profits which are entitled to the benefit under Section 80-1A. In **Sterling Food** the Apex Court has also laid down a test as to what is the source of income. In the present case the source of income transport subsidy is not the business of the assessee but the scheme framed by the Central Government.

Applying the tests laid down in **Liberty India's** case and **Sterling Food's** case it is apparent that the transport subsidy received by the assessee is not a profit

derived from business since it is not an operational profit. The source of the subsidy is not the business of the assessee but scheme of the Central Government.

In view of the above discussion, we are clearly of the view that the questions have to be answered in favour of the revenue and against the assessee. The appeals are accordingly dismissed.

(Deepak Gupta), J.

November 30, 2009 (V. K. Ahuja), J.
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