

****THE HON'BLE SRI JUSTICE L.NARASIMHA REDDY
AND
*THE HON'BLE SRI JUSTICE CHALLA KODANDA RAM
+I.T.T.A.No.214 of 2003***

% Dated 15.10.2014

The Commissioner of Income Tax-III.

... Appellant

\$ M/s. Surana Strips Limited.

....Respondent

! Counsel for the appellant : Sri J.V.Prasad

^ Counsel for respondent : Sri Y.Ratnakar

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? Cases referred:

1. 262 ITR 278
2. (1993) 203 ITR 881 (S.C.)
3. (2010) 325 ITR 136 (Karn.)
4. (1948) 16 ITR 325 (PC)

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JUDGMENT: (Per LNR,J)

The respondent is an industrial undertaking. In its returns submitted for the assessment year 1993-94, it claimed deduction under Section 80HH of the Income Tax Act, 1961 (for short 'the Act'), for a sum of Rs.20,40,341/-. According to it, the said

amount represents the interest on belated payment of the purchasers of the product manufactured by it. In his order of assessment, dated 15.03.1996, the Assessing Officer disallowed the deduction by treating it as not qualified under Section 80HH of the Act. The respondent filed an appeal before the Commissioner (Appeals). The appeal was allowed through order, dated 10.07.1996. Aggrieved by that, the Revenue filed I.T.A.No.1671/Hyd/96 before the Hyderabad Bench of the Income Tax Appellate Tribunal. The appeal was dismissed through order, dated 29.05.2001. Hence, this further appeal under Section 260-A of the Act by the Revenue.

The following substantial question of law is canvassed before this Court:

“Whether on the facts and in the circumstances of the case, the Tribunal is correct in law in holding that the interest earned from Trade Debtors on account of delayed payment should be treated as profits ‘derived from’ the Industrial Undertaking of the assessee for the purpose of computing the relief u/s 80HH of the Income Tax Act, 1961”

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Sri J.V.Prasad, learned counsel for the appellant submits that the profits and gains, that are derived by the respondent from the activity of manufacture of cold roll strips alone, that qualify for deduction, to the extent of 20% under Section 80HH of the Act and the interest on belated payment does not at all fall into that category. He submits that it is only the cost of the product manufactured and sold by the respondent that becomes the income, and thereby, the profit, referable to Section 80HH of the Act and not interest on belated payment. He also submits that the Assessing Officer has analysed the matter with reference to the relevant facts but the Commissioner and the Tribunal have taken a hyper technical view of the matter. Reliance is placed upon the Judgment of the Supreme Court in

Commissioner of Income Tax vs. Pandian Chemicals Ltd. ^[1].

Sri Y.Ratnakar, learned counsel for the respondent, on the other hand, submits that it is well-known trade practice to supply the goods on credit and to receive the consideration with interest for the belated payment and the interest becomes part of the

sale consideration. He submits that whether one goes by the trade practice or the mandate under Section 61 of the Sale of Goods Act, the interest becomes inseparable part of the consideration. Learned counsel further submits that the subject matter of the judgment of the Supreme Court in **Pandian Chemicals Ltd**'s case (1 supra), is incomparably different from that of the present case. He has relied upon the judgment of the Supreme Court in **Commissioner of Income-Tax vs. Govinda Choudhury and sons.**^[2] and of the Karnataka High Court in **Commissioner of Income-Tax vs. Sri Hariram Hotels P. Ltd.**^[3]

Chapter VIA of the Act provides for deduction of profits and gains of a stipulated fraction from the income derived from the concerned activity. The effort of the Parliament is to encourage industrialists and entrepreneurs to undertake an activity, which in turn may add to the economy of the Nation. The common phrases that occur in all these provisions that occur in Chapter VIA of the Act particularly under the Heading "C-Deduction in respect of certain incomes", is where the gross total income of an assessee includes any profits and gains derived "from concerned activity", there shall, in accordance with and subject to the provisions of the Section, be allowed, in computing the total income of the assessee, a deduction from such profits and gains of an amount equal to 20% thereof. Almost all the principal sections, which provide for deductions, employ this language and the details as to the deduction or the definition of the activity are supplemented in Sub-sections or Clauses thereof. Sub-Section (1) of Section 80HH of the Act reads as under:

"Where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking, or the business of a hotel, 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 twenty percent thereof."

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The expression "derived from" that occurs in quite large number of sections of the Act has been the subject matter of

interpretation by several High Courts and the Supreme Court.

It is not uncommon that an assessee would have several sources of income and there may be a tendency to derive the benefit of deduction provided for under a particular provision; in respect of incomes, which genuinely do not fall into that category. Equally the attentive Assessing Officers would scrutinize the matter and disallow the claims, if according to them they do not partake the same character as enunciated in a particular provision.

The facts of the present case do not pose much of a difficulty. Unlike in several other cases, the assessee in the instant case was undertaking only one activity viz., manufacture of cold roll strips. The income posted by him in the income tax returns comprised mostly of the sale proceeds of product manufactured by it. The books of account revealed the consideration that is received for the product that is sold from time to time. Wherever the payment was made at a subsequent stage, and the purchaser paid interest thereon, as per the terms of sale, the actual sale consideration and the component of interest were shown separately.

Honestly enough, the respondent has shown the actual consideration of the product manufactured and sold by it on the one hand, and the interest received by it on account of belated payment of the consideration by the purchasers, on the other hand. The interest component aggregated to Rs.20,40,341/- for the concerned assessment year. The Assessing Officer treated this as not falling within the ambit of Section 80HH of the Act.

The income of a manufacturer of a particular item is mostly in the form of the receipt of sale consideration. What constitutes consideration, is not susceptible of any precise definition. Though on a strict financial discipline, one may determine the cost of the product by taking into account the factors such as the cost of raw-material, the cost of manufacture (which may take in its fold, the expenditure incurred towards establishment and power and wages to workers), the component of taxes and the margin of profit. Many a time, several external factors influence the determination of price, requiring upward or downward

revision. For instance, if the cost of the product is determined on scientific lines to be at Rs.1000/- per unit, all surrounding circumstances being normal, the manufacturer may sell it at the same price. However, if there is slump in demand, an occasion may arise to offer discount on it, in which case, the price may stand reduced. Conversely, if the demand is heavy and the supply is less, a premium may accrue to the product and depending upon the financial status and discipline of the manufacturer or trader, the product may be sold at a phenomenally higher price.

Whatever may be the fluctuations in the trade in relation to a product, what becomes relevant from the point of view of Section 80HH of the Act, is the profit and gain, which the assessee has derived from the activity. Whether to promote sales or to ensure that the stock, which has piled up in a particular period is cleared, or to accommodate a regular customer, the manufacturer may offer the sale of the product on credit, subject to payment of interest for the belated payment. Even these aspects become almost irrelevant in the context of Section 80HH of the Act and what becomes material is the actual amount that is received by the manufacturer. Not only from the point of view of Section 80HH of the Act but also in the ordinary parlance, the interest paid by the purchaser on account of belated payment, becomes part of the consideration and partakes the character of price. Another way of looking at the matter is as to what was the occasion or basis for a person to pay the amount representing the interest. The answer would connect the same to the product and one does not have to put any further questions to relate the same, to the activity of the assessee. This fits into the observation of the Privy Council in ***CIT v. Raja Bahadur Kamakhya Narayan Singh***^[4], which reads:

"The word 'derived' is not a term of art. Its use in the definition indeed demands an enquiry into the genealogy of the product. But the enquiry should stop as soon as the effective source is discovered. In the genealogical tree of the interest land indeed appears in the second degree, but the immediate and effective source is rent, which has

suffered the accident of non-payment. And rent is not land within the meaning of the definition."

In **Govinda Choudhury and sons.**'s case (2 supra), the Hon'ble Supreme Court observed in this context as under:

"It is well-settled that interest can be assessed under the head "Income from other sources" only if it cannot be brought within one or the other of the specific heads of charges. We find it difficult to comprehend how the interest receipts by the assessee can be treated as receipts which flow to him dehors the business which is carried on by him. In our view, the interest payable to him certainly partakes of the same character as the receipts for the payment of which he was otherwise entitled under the contract and which payment has been delayed as a result of certain disputes between the parties. It cannot be separated from the other amounts granted to the assessee under the awards and treated as "income from other sources". The second question is, therefore, answered in favour of the assessee and against the Revenue."

Learned counsel for the appellant relied upon the judgment of the Supreme Court in **Pandian Chemicals Ltd**'s case (1 supra). In that case, the assessee sought to add to his income derived from manufacture of chemicals, the interest which was paid by the electricity supplier on the deposits made by the assessee. The Supreme Court held that hardly there exists any nexus between the two. There is not even a remote possibility to apply the ratio laid down in that case to the facts of the present case. It is a different matter that the Assessing Officer can certainly verify as to whether the interest was in fact paid or whether it was claimed on imaginary or surreptitious manner. In a given case, if it is found that the consideration was paid at the time of sale itself and still, the interest on it was sought to be added, necessary steps can be taken in this behalf. We do not find any basis to interfere with the order passed by the Tribunal.

Therefore, the appeal is dismissed.

The miscellaneous petition filed in this appeal shall also stand disposed of. There shall be no order as to costs.

L.NARASIMHA REDDY, J

CHALLA KODANDA RAM, J

Date: 15.10.2014

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