IN THE HIGH COURT OF ANDHRA PRADESH:
AT AMARAVATI
***

I.T.T.A.No.793 of 2006

Between:

Kanakadurga Agro Oil Products Limited, Gangur, Penamaluru Mandal, Krishna District.

.... Appellant

And

Assistant Commissioner of Income Tax,
Circle-I, Vijayawada.

....Respondent.

Date of Judgment pronounced on : 26.09.2022

THE HON'BLE SRI JUSTICE C. PRAVEEN KUMAR

AND

THE HON'BLE SRI JUSTICE A.V. RAVINDRA BABU

1. Whether Reporters of Local newspapers may be allowed to see the judgments? : Yes/No

2. Whether the copies of judgment may be marked to Law Reporters/Journals: Yes/No

3. Whether the Lordship wishes to see the fair copy of the Judgment? : Yes/No

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JUSTICE C. PRAVEEN KUMAR

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.... Appellant

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....Respondent.

! Counsel for the Appellant: Ms. Jyothi Ratna Anumolu

Counsel for the Respondent: Ms. M. Kiranmayee, Standing Counsel for Income Tax.

<Gist :

>Head Note:
? Cases referred:
1) (2002) 122 Taxman 516 (Madras)
2) (2006) 155 Taxman 330 (Guj)
3) (2003) 262 ITR 0278
4) (1999) 237 ITR 0579
5) (1948) 16 ITR 325 (PC)
6) (1955) 27 ITR 1 (SC)

THE HON'BLE SRI JUSTICE C.PRAVEEN KUMAR

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I.T.T.A.No.793 of 2006

JUDGMENT:- *(per the Hon'ble Sri Justice C. Praveen Kumar)*

The short point that arises for consideration in this appeal is with regard to the applicability of the words "derived from an industrial undertaking" as mentioned under Section 80(I) of the Income Tax Act, 1961 [for short, "I.T. Act"] to the case of the appellant.

2. The present appeal is filed under Section 260-A of the I.T. Act assailing the order in I.T.A.No.336/Vizag/2000 dated 13.06.2006.

3. The facts, in issue, are as under:-

(a) The assessee is engaged in business of manufacture and production of rice bran oil, other oils, oil cakes etc. The appellant is assessed to Income Tax by the Assistant Commissioner of Income Tax, Circle-I, Vijayawada at that material point of time. For the assessment year 1997-98, the company filed its returns on

27.10.1997 declaring the total income of Rs.23,67,220/-. While filing its return, the assessee claimed deduction of Rs.2,60,580/- under Section 80(I) of the I.T. Act. The return was taken up for scrutiny under Sections 143(2) and 142(1) of I.T. Act. The assessment was completed on 08.05.1998 by allowing deductions only to an extent of Rs.55,924/-. The reason for restricting the deduction appears to be that the interest paid was not derived from the business of the manufacture and production of the industrial undertaking.

(b) Aggrieved by the same, the assessee preferred an appeal to CIT Appeals (IV), Hyderabad bearing ITA No.154/CIT(A)/VJA/98-99. The Commissioner of Appeal found that as the interest amount of Rs.14,60,994/- was received from the debtors, on account of delay in payment of sale proceeds, the same cannot be said to have derived from industrial undertaking and accordingly allowed the appeal in part *vide* Order dated 31.07.2000. The assessee carried the matter in appeal before the Income Tax Appellate Tribunal, Visakhapatnam Bench in ITA No.336/Vizag/2000. The Judicial Member of the Tribunal accepted the plea of the assessee in holding that the

amount was from the business of the manufacture and production by following the decisions laid down by various Courts. However, the Accountant Member disagreed with the view expressed by the Judicial Member and rejected the plea of the assessee, as such, the matter was referred to a Third Member under Section 255 (4) of the I.T. Act.

(c) The issue before the Third Member was "***whether on the facts and circumstances of the case, the assessee shall be entitled for deduction under Section 80(I) in respect of interest received on delayed payment by the customers?***

(d) The Third Member agreed with the view expressed by the Accountant Member and held that the interest receivable from the debtors on account of the delayed payments of sale proceeds is not an income derived from the business of industrial undertaking. The said conclusion was mainly based on the judgment in **Nirma Industries vs. ACIT reported in (1995 ITD 199).**

4. Aggrieved by the same, the assessee preferred the present appeal.

5. Ms. Jyothi Ratna Anumolu, learned counsel representing Sri Challa Gunaranjan, learned counsel for the appellant, mainly submits that the Tribunal erred in coming to a conclusion that the interest earned from debtors, payable for the delay, in remitting the sale proceeds to the assessee is not an income derived from the industrial undertaking engaged in the business of manufacture and production. She relied upon the judgments of Madras High Court in ***Commissioner of Income Tax vs. Madras Motors Limited[1],*** and the judgment of High Court of Gujarat in ***Nirma Industries Limited vs. Deputy Commissioner of Income Tax[2].*** While distinguishing the ratio laid down in ***Pandian Chemicals Limited Vs. CIT[3]***, would contend that the Tribunal ought to have given the relief to the assessee.

6. Ms. M. Kiranmayee, learned Standing Counsel for Income Tax, appearing for the respondent, mainly relied upon the judgment in **Pandian Chemicals Ltd.** [cited 3 *supra*] and also the judgment of Hon'ble Supreme Court in ***Commissioner of Income Tax vs. Sterling Food,***

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[1] (2002) 122 Taxman 516 (Madras)
[2] (2006) 155 Taxman 330 (Guj)
[3] (2003) 262 ITR 0278

Mangalore[4], to contend that the interest paid on delayed payments cannot form part of same transactions, and as such, it cannot be said that it was a gain derived from its industrial undertaking.

7. The point that arises for consideration is, ***whether in the facts and circumstances of the case, the assessee is entitled for deduction under Section 80(I) of the I.T. Act?***

8. Section 80(I) of the Income Tax Act, 1961 reads as under:-

> **"80-I. <u>Deduction in respect of profits and gains from industrial undertakings after a certain date, etc</u>.**—(1) Where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking or a ship or the business of a hotel [or the business of repairs to ocean-going vessels or other powered craft], 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 per cent thereof:
>
> Provided that in the case of an assessee, being a company, the provisions of this sub-section [shall have effect in relation to profits and gains derived from an industrial undertaking or a ship or the business of a hotel]

[4] (1999) 237 ITR 0579

as if for the words — "twenty per cent" the words — "twenty-five per cent" had been substituted.

(1A) Notwithstanding anything contained in sub-section (1), in relation to any profits and gains derived by an assessee from—

(i) an industrial undertaking which begins to manufacture or produce articles or things or to operate its cold storage plant or plants; or

(ii) a ship which is first brought into use; or

(iii) the business of a hotel which starts functioning,

on or after the 1st day of April, 1990, [but before the 1st day of April, 1991], 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-five per cent thereof.

Provided that in the case of an assessee, being a company, the provisions of this sub-section shall have effect in relation to profits and gains derived from an industrial undertaking or a ship or the business of a hotel as if for the words — "twenty-five per cent" the words — "thirty per cent" had been substituted.]

(2) This section applies to any industrial undertaking which fulfils all the following conditions, namely:—

(i) it is not formed by the splitting up, or the reconstruction, of a business already in existence;

(ii) it is not formed by the transfer to a new business of machinery or plant previously used for any purpose;

(iii) it manufactures or produces any article or thing, not being any article or thing specified in the list in the Eleventh Schedule, or operates one or more cold storage plant or plants, in any part of India, and begins to manufacture or produce articles or things or to operate such plant or plants, at any time within the period of [ten years] next following the 31st day of March, 1981, or such further period as the Central Government may, by notification in the Official Gazette, specify with reference to any particular industrial undertaking;

(iv) in a case where the industrial undertaking manufactures or produces articles or things, the undertaking employs ten or more workers in a manufacturing process carried on with the aid of power, or employs twenty or more workers in a manufacturing process carried on without the aid of power:

Provided that the condition in clause (i) shall not apply in respect of any industrial undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such industrial undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section.

Provided further that the condition in clause (iii) shall, in relation to a small-scale industrial undertaking, apply as if the words —not being any article or thing specified in the list in the Eleventh Schedule had been omitted."

9. The controversy revolves around the word 'derived' and the word 'industrial undertaking'. The question is ***whether the interest paid on delayed payments form part of profits and gains derived from an industrial undertaking?***

10. Section 80HH of the I.T. Act, which deals with deductions in respect of the profits and gains from newly established industrial undertakings or Hotel business in backward areas also contains the phrase "profits and gains derived from an industrial undertaking." The word 'derived' has been construed by the Privy Council in ***CIT vs. Raja Bahadur Kamakhaya Narayan Singh[5] (1948) 16 ITR 325 (PC)*** wherein it was observed as under:-

> "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."

The above definition was approved and reported by a Constitution Bench of the Hon'ble Supreme Court in

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[5] (1948) 16 ITR 325 (PC)

Bacha F. Guzdar vs. CIT[6]. Having regard to the above, the Hon'ble Supreme Court in **Pandian Chemicals Ltd.** [cited 3 *supra*] observed that the word "derived from" in Section 80-HH of the Income Tax Act, 1961 must be understood as something which has direct or immediate nexus with the appellant's industrial undertaking.

11. As stated earlier, learned Standing Counsel for the Income Tax also relied upon a judgment in **Sterling Food** case [cited 4 *supra*]. In the said case, the Hon'ble Supreme Court while negating the claim of the assessee categorically observed that:

> "There must be, for the application of the words "derived from", a direct nexus between the profits and gains and the industrial undertaking."

12. It is to be noted here that in Pandian Chemicals, the assessee made deposits in the Tamil Nadu Electricity Board and was earning interest thereon. For getting power connection, every industrial undertaking had to maintain deposit in Electricity Board. The Division Bench held that the interest derived from such deposits could not be said to have been derived from industrial undertaking.

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[6] (1955) 27 ITR 1 (SC)

This view of the High Court was accepted by the Hon'ble Apex Court. Therefore, any interest earned by the assessee from the bank deposits or from deposits made which would not have a direct nexus with the business/industrial undertaking of the assessee cannot be an incidental income and such income has to be ignored for claiming benefits under Section 80-HH of the I.T. Act.

13. The question before **Sterling Food** [cited 4 *supra*] was whether the income derived by the assessee by the sale of the import entitlements was profit and gain derived from its industrial undertaking of processing sea food. After referring to Section 80-HH of the I.T. Act; the judgments in (1) Cambay Electric Supply Industrial Co. vs. CIT reported in (1987) 113 ITR 84 (SC); (2) CIT Madras-I vs. Wheel and Rim Company of India Ltd. reported in (1997) 107 ITR 168 (Mad) and (3) National Organic Chemical Industrial Ltd. vs. Collector of Central Excise, Bombay reported in JT 1997 (1) 637 (SC), the Hon'ble Supreme Court held that source of import entitlements cannot be said to be the industrial undertaking of the assessee. The Court held that the source of import entitlement can, in the circumstances, only be said to be

the Export Promotion Scheme of the Central Government where under the export entitlements become available. Therefore, 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 facts of the said case, it was held that a nexus was not direct, but only incidental. Hence, the benefit was not given.

14. At this stage, it would also be appropriate to refer the judgment of **Cambay Electrical case [(1987) 113 ITR 84 (SC)]** wherein it was held that:

> "The expression 'attributable to' was wider in import than the expression 'derived from'. The expression of wider import, namely, 'attributable to', was used when the legislature intended to cover receipts from sources other than the actual conduct of the business."

15. The question now is, ***whether the ratio laid down in the judgments referred to above apply to the case on hand?***

16. As stated earlier, the wording in Section 80-HH of the I.T. Act and in Section 80(I) of the I.T. Act, are almost identical, in so far as the words in dispute. As stated earlier, the issue in the instant case is whether the

interest paid by the customers for delayed payments on the supplies received by them will be liable for exemption or in other words whether it can be said that the profit or gain received has been derived from an industrial undertaking? The Madras High Court in **Madras Motors's** case [cited 1 *supra*], held as under:

> "...the word, 'derived' is not a term of art and 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 and the profit or gain can be said to have been 'derived' from an activity carried on by a person, if the said activity is the immediate and effective source of the said profit or gain... there must be a direct nexus between the activity and the earning of the profit or gain and the income, profit or gain cannot be said to have been derived from any activity merely by reason of the fact that the said activity may have helped to earn the said income or profit in an indirect or remote manner...."

17. Apart from that, the Hon'ble Supreme Court in the judgment referred to earlier, more particularly in **Sterling Food** Case [cited 4 supra], categorically observed that for application of the words 'derived from', a direct nexus between the profits and gains and the industrial undertaking has to be established. The instant case, is not one, where the interest received was incidental or ancillary

to the deposit made. The interest received is a direct consequence of the goods supplied. The interest is directly relatable to the amounts received by the assesse during the course of its business on account of sale by the assessee to his customers.

18. In ***Nirma Industries*** [cited 2 *supra*]**,** the Division Bench of Gujarat High Court dealt with a fact situation where late payment was received by the assessee due to default of the customers. The assessee authority held that the same has nothing to do with the industrial undertaking or the manufacturing activity of the assessee. On appeal, the Commissioner (Appeals) held that the assessee was entitled to include interest while computing the profits and accordingly granted relief under Section 80(I) of the I.T. Act. On Revenue's appeal, the Tribunal disagreed with the view expressed by the Commissioner (Appeals). Challenging the same, a writ petition came to be filed before the High Court. It would be just and proper to extract the relevant portion of the order, which is as under:-

> "30. The Tribunal was, therefore, not justified in holding that while computing deduction under Section 80-I of the Act, interest received from trade debtors towards late payment of sales consideration is required to be excluded from the profits of the industrial undertaking as the same cannot be stated to have been derived from the business of the industrial undertaking."

19. Similar view was taken by the Madras High Court in **Madras Motors case** [cited 1 *supra*]. It would be appropriate to extract the relevant portion of the order, which is as under:-

> "3.2. Let us now consider the interest earned by the assessee on the belated payments. There can be no doubt that this interest would, however, be directly relatable to the business of the assessee of forgings. If the purchasers of the forgings did not make the payments of the forgings and then agree to pay the interest on the delayed payments, the said interest would have its direct nexus with the business of forgings. The true test would be whether such interest would be available to the assessee otherwise also. The answer to the question would be certainly in negative. The interest being directly relatable only to the amounts received by the assessee during the course of its business on account of the sale of forgings, would have to be included as the profits and gains derived from the business of the assessee. We hold that this part of the interest would be entitled to be covered by section 80-HH."

20. As stated earlier, the fact situation in the case on hand also relates to payment of interest on delayed

payments of sale proceeds to the assessee. As observed in the Gujarat High Court that there are two methods of realizing sale consideration, the object being to realise sale proceeds at the earliest and without delay. To avoid any loss to the assessee on account of the delayed payments, for the goods supplied, two contingencies can be stipulated (1) charging little higher rate or (2) collecting interest on delayed payments. By this, the transaction would not be incidental or different. In our view, it forms part of the same transaction as the amount due for the goods sold is being paid with some delay for which an interest is being collected.

21. Applying the ratio laid down in the above judgments to the case on hand, it is clear that there is direct nexus between the interest received, goods sold and the payments made including interest for the goods sold. Hence, it can be said that the profits and gains derived was from the business of the assessee and accordingly the interest received on delayed payments for the goods supplied/sold would be entitled to relief of exemption under Section 80(I) of the I.T. Act.

22. Accordingly, the appeal is ***allowed***. There shall be no order as to costs.

Miscellaneous petitions pending, if any, shall stand closed.

JUSTICE C.PRAVEEN KUMAR

JUSTICE A.V. RAVINDRA BABU

Date: 26.09.2022

Note: LR copy to be marked.
B/o.MS

THE HON'BLE SRI JUSTICE C.PRAVEEN KUMAR

AND

THE HON'BLE SRI JUSTICE A.V. RAVINDRA BABU

I.T.T.A.No.793 of 2006

(per the Hon'ble Sri Justice C. Praveen Kumar)

Date: 26.09.2022

MS