Before S.J. Vazifdar, C.J. & Deepak Sibal, J.

COMMISSIONER OF INCOME TAX (CENTRAL), LUDHIANA—*Appellant*

versus

M/S HERO CYCLES LIMITED, LUDHIANA—*Respondent*

ITA No. 52 of 2003

September 19, 2016

Income Tax Act, 1961—S. 88HHCC—Whether income by way of interest on amounts loaned and advanced would be considered as business income under Section 80HHC—No—even if the assessee's Memorandum of Association entitles it to carry on the business of money lending unless such activity is shown—Such income shall remain business income.

Held that, thus, even assuming that the assessee's Memorandum of Association entitles it to carry on the business of money lending, the income by way of interest on amounts lent and advanced would not be considered as business income unless the assesssee establishes that it in fact carries on the business of money lending. There is nothing on record that establishes that the assessee carries on the business of money lending. The income received from loans, advances made by the asseessee must, therefore, be computed under the head "income from other sources" and not under the head "Profits and gains of business".

(Para 11)

Zora Singh Klar, Senior Standing Counsel, *for the appellant-department.*

Akshay Bhan, Senior Advocate with Alok Mittal, Advocate, for the respondent.

S.J. VAZIFDAR, CHIEF JUSTICE

(1) This is an appeal against the order of the Tribunal relating to the assessment year 1989-90. By an order dated 11.08.2003 this appeal was admitted on the following questions of law:-

> Whether, on the facts and in the circumstance of the case, the ITAT was right in holding that interest from others and also from IDBI constitute profit from the business for the purpose of computing deduction under Section 80HHC"?

> (2) "Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in law in holding that for the purpose of computing deduction u/s 32AB, all the receipts including non-business receipts viz the interest from others of Rs.1,05,50,306/-, the interest from IDBI of Rs.4,14,375/-, the rent receipt of Rs.2,07,584/- and the dividend income of Rs.19,52,108/-, form part of the "Profit of eligible business"?

The answer to either of the questions would also answer the other question.

(2) Section 80HHC in so far as it is relevant and as it stood at the relevant time read as under:-

> "Deduction in respect of profits retained for export business.
>
> ....
>
> (3) For the purpose of sub-section (1), profits derived from the export of goods or mechandise out of India shall be:-
>
> (a) In a case where the business carried on by the assessee consists exclusively of the export out of India of the goods or mechandise to which this section applies, the profits of the business as computed under the head 'profits and gains of business of profession':
>
> (b) In a case where the business carried on by the assessee does not consist exclusively of the export out of India of the goods or merchandise to which this section applies, the amount which bears to the profits of the business as computed under the head 'profits and gains of business or profession' the same proportion as the export turnover bears to the total turnover of the business carried on by the assessee."

(3) In the assessment order, it is observed that the assessee had received a sum of Rs.1.50 crores towards interest; that the assessee was not involved in the business of money lending; that the assessee did not have a licence for money lending and that the interest on loans earned by the assessee would, therefore, fall within section 56, i.e. income from other sources and would not constitute income from business. It was further observed that the advances were made by the assessee to parties in the same group which was referred to as the "Hero Group".

The CIT (Appeals) upheld the order of the Assessing Officer without furnishing any further reasons.

(4) The Tribunal in the impugned order observed that it was clear from the assessment order that the said interest had been assessed by the Assessing Officer under the head "profit and gains of business or profession". Following the decision of a Division Bench of this Court in ***CIT*** *versus* ***Isher Dass Mahajan and sons***[1], the Tribunal set aside the order of the CIT (Appeals) and directed the Assessing Officer to compute the deduction under section 80HHC after including the income as profits of business.

(5) Mr. Zora Singh Klar, learned counsel appearing on behalf of the appellant submitted that the Tribunal's finding that the said interest had been assessed by the Assessing Officer under the head "Profits and gains of business" is factually incorrect. In this regard, he invited our attention to that part of the assessment order where the assessee's claim under section 80HHC was dealt with. It is mentioned that the business profits as calculated while computing the deduction under Section 32AB would be followed. The assessment order while dealing with the assessee's claim for deduction under section 32AB, excluded the said income on the ground that it is not business income. The said interest was also not considered as business income. The assessment order, however, does not record that the said interest was not assessed as income from business. The exclusion of the said interest while computing the deductions claimed under Section 32 AB and 80HHC does not indicate that the income from interest was not computed under the head "Profits and gains of business" while computing the income. It merely indicates that it was excluded while computing the deductions claimed under sections 32AB and 80HHC.

(6) Mr. Alok Mittal, the learned counsel appearing on behalf of the respondent relied upon para 4(i) of this appeal where it is stated that by mistake in the computation of income, the said interest was not assessed under the head "income from other sources". It is averred that the mistake cannot override the specific finding. This, he submitted, is an admission that the said income was assessed under the head "Profits and gains of business".

(7) We will assume this to be so. The position then would be that the amount received towards interest was assessed under the head

[1] (2002) 253 ITR 284

"Profits and gains of business" while computing the income but was excluded only for the purposes of considering the deductions under sections 32AB and 80HHC.

(8) The question that arises is if in view of the assessment order having computed the interest under the head "Profits and gains of business", we are precluded from considering whether the interest falls under the head "Income from other sources". Mr. Mittal contended that the Assessing Officer having computed the income on the basis that it falls under the head "Profits and gains of business", the authorities and the Courts are bound to proceed on that basis for all purposes including for the purposes of considering the assessee's application for deduction under sections 32AB and 80HHC. He further contended that in any event the interest received constituted the assessee's business income.

(9) We have come to the conclusion that the interest received by the assessee was not business income and is liable, therefore, to be computed under the head "Income from other sources". We have also held that it is open to the authorities under the Act and to the Courts to direct the Assessing Officer to pass a fresh assessment order after considering the income under the correct head for all purposes in the assessment order.

(10) We will, however, first examine whether the interest received falls under the head "Profits and gains of business" or under the head "Income from other sources".

(11) The Assessing Officer noted that the details submitted by the assessee regarding the loans in the relevant assessment year as well as in the earlier years reveal that the interest was received from persons to whom the company advanced loans at the time of need. As noted earlier, the assessee, admittedly, does not have a money lending business. The assessee would be entitled to have the interest received computed under the head "Profits and gains of business" only in the event of money lending being its business. If it is not, the interest must be computed under the head "Income from other sources". The Assessing Officer also noted that in the previous assessment year, namely, Assessment Year 1988-89, the CIT (A) held that interest received from loans and advances given to Directors or individuals or other sister concerns for any liability paid on behalf of certain parties to be income from other sources and, accordingly, excluded the same from the eligible profits to which Section 32AB is applicable. If that is

correct, it must also be excluded from the eligible profits to which Section 80HHC is applicable.

(12) Mr. Mittal, however, contended that the assessee's Memorandum of Association and in particular clause 9 to 10 thereof entitles it to lend money and to make investments. We will assume that to be so. It would make no difference. Merely because the Memorandum of Association of a company entitles it to carry on a particular activity, it does not follow that it, in fact, does so. The Memorandum of Association only entitles a company to carry on activities mentioned therein. A company is not bound to carry on all the activities mentioned in its Memorandum of Association. It is well known that usually the Memorandum of Association entitles a company to carry on various activities, although the company has no intention of doing so at the time of the preparation of the Memorandum of Association. Such objects are included for convenience in the event of the company deciding in future to undertake such activities for otherwise it would require the company to go through the procedure of making an application before the Court or the Company Law Board for amending its Memorandum of Association. Thus, even assuming that the assessee's Memorandum of Association entitles it to carry on the business of money lending, the income by way of interest on amounts lent and advanced would not be considered as business income unless the assessee establishes that it in fact carries on the business of money lending. There is nothing on record that establishes that the assessee carries on the business of money lending. The income received from loans, advances made by the assessee must, therefore, be computed under the head "Income from other sources" and not under the head "Profits and gains of business".

(13) Mr. Mittal submitted that the Assessing Officer having assessed the said income under the head "Income from business" was bound to consider it as business income while considering the assessee's claim under Section 32AB and Section 80HHC. He relied upon the judgment of a Division Bench of this Court in ***CIT*** *versus* ***M/s Avery Cycles Industries Limited***[2]. The Division Bench framed the following questions of law and proceeded to answer the same as follows:

> "(iii) Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in directing to consider

[2] (2008) 296 ITR 393

interest income as forming part of business profits for computing deduction under Section 80HHC?

13. As far as question of addition of the amount of interest of the kind received by the assessee for the purpose of computation of business is concerned, in our view, the answer thereto is clearly available in the definition of "profits of the business", contained in Clause (baa) of Section 80HHC of the Act, as reproduced above, from where it is evident that 'profits of the business" means the profits and gains of business or profession, as computed under the head "Profits and gains of business or profession" as reduced by the items, provided for in the definition. A perusal of the assessment order shows that while dealing with the deduction under Section 80HHC of the Act, receipt of interest by the assessee from IT Department, on securities from Punjab State Electricity Board and on security deposit for car was held to be not connected with the business activity and the AO treated the same as income from other sources. However, while computing the income from business or profession, the amount of interest so earned by the assessee, as mentioned above, was taken as part of the business income only and the same was not reduced therefrom for dealing under the head "Income from other sources". While considering the appeal filed by the assessee on this issue, the CIT(A) rejected the same. Before the Tribunal, the assessee succeeded.

14. Once at the time of passing of the assessment order in computing the income from business or profession, the amount of receipt of interest, as mentioned above, has been shown and assessed as income from business or profession, there is no reason for reducing the same out of the income from business or profession for the purpose of calculation of deduction under Section 80HHC of the Act, as after including the same in the income from business or profession, the reduction, as envisaged under that provision, would be carried out. This is clear even from what the Tribunal has directed. Accordingly, we do not find any merit in this contention of the Revenue and hold that once the income is assessed as income from business or profession, the same has to be taken as such for the purpose of

calculation of profits of the business in terms of Clause (baa) of Section 80HHC of the Act after reducing therefrom 90 per cent of the amount, so referred in the clause."

(14) In ***CIT*** *versus* ***M/s Avery Cycles Industries Limited***[3], while dealing with the deduction under section 80HHC, the interest received was held to be not connected with the business activity and the assessing officer treated the same as income from other sources, but, while computing the income from business or profession the same was taken as a part of the business income and was not reduced therefrom, for dealing under the head "income from other sources".

(15) We are, undoubtedly, bound by the judgment of the Division Bench of this Court. Had the matter before us rested in the same terms as the case before the Division Bench, we would have refrained from going any further. It would not have been necessary then for us to go into the question as to whether the interest received by the assessee before us constituted business income or not. The matter before us, however, does not rest at the same stage or in the same terms as it did in the case before the Division Bench. In that case, the Department did not make any application for the Assessing Officer to recompute the assessment in accordance with the correct position. The Department did not contend there that the amount received was not, in fact, business income. It retained its stand and, in any event, does not appear to have applied to the Court for an order directing the Assessing Officer to pass a fresh assessment order by treating the amount received under the correct head for all purposes. In that event, the Assessing Officer was indeed bound to have considered the income as business income even for the purposes of calculating the benefit under Section 80HHC. However, in the case before us, Mr. Klar, the learned counsel appearing on behalf of the Department submitted that the interest received by the assessee did not constitute business income and is, therefore, liable to be taxed under the head "Income from other sources". He stated that the Revenue would press for the interest to be computed under the correct head, namely, "Income from other sources" and not under the head "Profits and gains of business" for all purposes and not merely for the purpose of sections 32AB and 80HHC. A statement to this effect was not made to the Division Bench in CIT vs. M/s Avery Cycles Industries Limited (supra). The case is, therefore, distinguishable for this reason.

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[3] (2008) 296 ITR 393

(16) For the same reasons, the judgment of the Bombay High court in ***Alfa Laval India Ltd***. *versus* ***Deputy Commissioner of Income tax***[4] is distinguishable.It was held:-

> "In our opinion, the submissions made on behalf of the assessee deserve to be accepted. In the present case, the assessing officer has computed the income by way of interest from the customers, sales tax set off, claims, refunds, etc. under the head "Profits and gains of business or profession". To put it differently, the Assessing Officer has not assessed the interest income from customers, sales tax set off, etc. under the head "Income from other sources" or under any other head. Having assessed these incomes under the head "Profits and gains of business or profession", it was not open to the Assessing Officer to treat these incomes as if assessed under the head "Income from other sources", so as to exclude the same from the business profits while computing the deduction under section 80HHC of the Income-tax Act. A Perusal of the assessment order clearly shows that the amounts in question have not been assessed under the head "Income from other sources", but, the same have been assessed under the head "Profits and gains of business or profession". Under section 80HHC(3) relevant to assessment year 1989-1990, the deduction was to be computed with reference to the profits of the business as computed under the head "Profits and gains of business or profession". In the present case, the interest income from customers and sales tax set off have been computed and assessed under the head "Profits and gains of business or profession" as part of the operational income and not under the head "Income from other sources". Therefore, the said income could not be deducted from the business profits while computing the deduction under section 80HHC of the Income- tax Act. The decisions relied upon by the Tribunal have been distinguished in the case of Bangalore Clothing Co. [2003] 260 ITR 371 (Bom). In the case of Bangalore Clothing Co. [2003] 260 ITR 371 (Bom), it is held that the Assessing Officer must ascertain the nature of receipt in each case independently. Interest income may or may not be out of business activity. If it is not part of operational

[4] (2004) 266 ITR 418

> business income, then, the Assessing Officer would have been justified in excluding the same for the purpose deduction under section 80HHC of the Act. However, in the present case, the Assessing Officer has accepted that the interest income received from customers as well as sales tax set off are assessable under the head "Profits and gains of business or profession". Therefore, having accepted the said income as part of the business profit, the same could not be excluded from business profits while calculating deduction under section 80HHC of the Act."

(17) Assuming that the said income is income from business, Mr. Klar's approach commends itself to us. It would lead to a correct assessment order being passed. To leave that matter as it is would not. It would, in fact, endorse and perpetuate the error in all aspects of the assessment order.

(18) Mr. Klar mentioned that as a matter of course several Assessing Officers do not assess the income under the correct heads on the presumption that it would make no monetary difference, i.e., it would be tax-neutral. He submitted that this is the reason why in several cases although the Assessing Officers come to the conclusion that the income falls under one head, while passing the final assessment order, they do not take the trouble of mentioning the amount under the correct head of income. If that is so, it is erroneous.

(19) Firstly, the assessment order must reflect the correct position. Secondly, it is not always that a computation under the wrong head would have no tax effect. For instance, a loss under one head may not be permitted to be carried forward and adjusted against the loss under another head. Further, an error in including the income under the wrong head would result in multiple errors as the case before us itself demonstrates. On account of the income being computed under the wrong head of income in the computation of income, the error is carried forward while computing the deductions under sections 32AB and 80HHC. Moreover it is possible that the assessment could have an impact in the event of there being any amendment to the law. It is desirable, therefore, that the assessment order should reflect the correct position.

(20) This view is not contrary to or in conflict with the judgment of the Division Bench in ***CIT*** *versus* ***Avery Cycles Industries Limited*** *(supra)*. At the cost of repetition, the Department in that case

did not make an application similar to the one made by Mr. Klar before us. Nor did the Department in that case agree that a fresh assessment order would be passed in accordance with the correct position in all respects relating to the assessment. There is no warrant for knowingly including amounts under a wrong head. To insist upon an error being continued invites the authorities and the court to endorse the error. There is nothing in law or in principle that requires or even permits this. There is nothing in law or in principle that prohibits the authorities under the Act or the Court from returning a finding regarding the correct head under which the income ought to be assessed and then directing the Assessing Officer to pass a fresh assessment order in accordance with the finding for all purposes. This course commends itself to us.

(21) Mr. Mittal submitted that under sub-section (3) of Section 80HHC the profits derived from export of goods or merchandise out of India shall be the amounts which bear to the profit of the business as computed under the head "Profits and gains of business or profession". He submitted that the Assessing Officer has computed the interest under the head "Profits or gains of business". He was bound by the terms of sub-section (3) itself to consider the same as business income.

(22) The argument begs the question it must first be determined as to whether the income is business income or not and thereafter consider the same for the purpose of section 80HHC. What sub-section (3) requires is a consideration of the profits of the business as rightly computed under the head "Profits and gains of business". It cannot possibly require a consideration of the amounts wrongly computed under the head "Profits and gains of business".

(23) Question No.1 is, therefore, answered in favour of the appellant/Revenue.

(24) It was initially conceded that the answer to question No.2 would follow the answer to question No.1. Mr. Mittal, however, raised an additional contention based on Section 32AB as regards this question.

(25) Section 32AB, as it then was and so far as it is relevant, read as under:-

> "Investment deposit account 32-AB..-- (1) Subject to the other provisions of this section, where an assessee, whose total income includes income chargeable to tax under the

head "Profits and gains of business or profession", has, out of such income,--

(a) deposited any amount in an account (hereafter in this section referred to as deposit account) maintained by him with the Development Bank before the expiry of six months from the end of the previous year or before furnishing the return of his income, whichever is earlier; or

(b) utilised any amount during the previous year for the purchase of any new ship, new aircraft, new machinery or plant, without depositing any amount in the deposit account under clause (a), in accordance with, and for the purposes specified in, a scheme (hereafter in this section referred to as the scheme) to be framed by the Central Government, or if the assessee is carrying on the business of growing and manufacturing tea in India, to be approved in this behalf by the Tea Board, the assessee shall be allowed a deduction (such deduction being allowed before the loss, if any, brought forward from earlier years is set off under Section 72) of--

(i) a sum equal to the amount, or the aggregate of the amounts, so deposited and any amount so utilised; or

(ii) a sum equal to twenty per cent of the profits of eligible business or profession as computed in the accounts of the assessee audited in accordance with sub-section (5), whichever is less:

Provided that where such assessee is a firm, or any association of persons or any body of individuals, the deduction under this section shall not be allowed in the computation of the income of any partner, or as the case may be, any member of such firm, association of persons or body of individuals.

(2) For the purposes of this section, -

(i) "eligible business or profession" shall mean business or profession, other than-

(a) the business of construction manufacture or production of any article or thing specified in the list in Eleventh Schedule carried on by an industrial undertaking, which is

not a small-scale industrial undertaking as defined in section 80HHA;

(b) the business of leasing or hiring of machinery or plant to an industrial undertaking, other than a small-scale industrial undertaking as defined in section 80HHA, engaged in the business of construction, manufacture or production of any article or thing specified in the list in the Eleventh Schedule;

....

(3) The profits of eligible business or profession of an assessee for the purpose of sub-section (1) shall,-

(a) in a case where separate accounts in respect of such eligible business or profession are maintained be an amount arrived at after deducting an amount equal to the depreciation computed in accordance with the provisions of sub-section (1) of Section 32 from the amounts of profits computed in accordance with the requirements of Parts II and III of the Sixth Schedule to the Companies Act, 1956 (1 of 1956), as increased by the aggregate of--

....

(b) in a case where such separate accounts are not maintained or are not available, be such amount which bears to the total profits of the business or profession of the assessee after allowing depreciation in accordance with the provisions of sub- section (1) of section 32, the same proportion as the total sales, turnover or gross receipts of the eligible business or profession bear to the total sales, turnover or gross receipt of the business or profession carried on by the assessee."

(26) Mr. Mittal submitted that even if under the Income Tax Act, the income falls under the head "Income from other sources" and not under the head "Profits and gains of business", the assessee would be entitled to a deduction on the amount of profit computed in accordance with Part-II and Part-III of the VIth Schedule of the Companies Act. He based his contention essentially on sub-section (3)(b) of Section 32AB which admittedly is applicable to the assessee's case.

(27) Firstly, it is necessary to note that sub-section (1) makes it clear that Section 32AB is applicable to an assessee whose total income includes income chargeable to tax under the head "Profits and gains of

business or profession". The last words of the opening part of sub-section (1) "out of such income" make this clearer. What follows is in respect of income chargeable to tax under the head "Profits and gains of business or profession". Clearly, therefore, it is business income only that is dealt with under sub-section (1).

(28) Mr. Mittal's reliance upon sub-section (2) is not well-founded. Indeed the assessee's business is an eligible business within the meaning of sub-section (2). Sub-section (2) only specifies what an eligible business is. Every eligible business is, however, not entitled to a deduction under Section 32AB. An eligible business is entitled to a deduction only in respect of its income chargeable to tax under the head "Profits and gains of business or profession".

(29) Mr. Mittal then relied upon sub-section (3)(b). He contends that the total profits of an assessee's business must be as computed in accordance with Parts-II and III of the VIth Schedule of the Companies Act. He relies upon the opening words of sub-section (3): "The profits of eligible business or profession of an assessee for the purpose of sub-section (1) shall, -". He then relies upon the fact that clause (a) of sub-section (3) provides that where separate accounts are maintained the profit is to be computed in accordance with the requirement of Parts-II and III of the Sixth Schedule of the Companies Act.

(30) The assessee's case admittedly falls under clause (b) of sub-section (3) and not clause (a). Clause (b) does not provide for the profits to be computed in accordance with the requirement of Parts-II and III of the Sixth Schedule to the Companies Act. These words are missing in clause (b). We see no reason then to read these words into clause (b). That would amount to re-writing clause (b) which is not permissible.

(31) The legislature having, in the same sub-section, provided for a particular manner of computation of profits in one clause but not in the other must be deemed to have intended the profits to be calculated differently in these sub-clauses. Mr. Mittal's submission is, therefore, rejected.

(32) It is true, as Mr. Mittal pointed out, that unlike as in Section 80HHC the words in clause (b) are not "profits of the business as computed under the head 'Profits and gains of business'". That, however, would make no difference. It was not necessary for the legislature to use the entire expression in clause (b) for sub-section (1) itself refers to income as including income chargeable to tax under the head "Profits and gains of business or profession".

The second question is, therefore, also answered in favour of the appellant/Revenue.

(33) Both the questions of law are answered in favour of the appellant/Revenue. The appeal is allowed. The impugned order of the Tribunal is set aside. The Assessing Officer is, however, directed to pass a fresh assessment order in accordance with this judgment.

Tejinderbir Singh