

IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCH "K", MUMBAI
BEFORE SHRI AMIT SHUKLA, JUDICIAL MEMBER AND
SHRI GAGAN GOYAL, ACCOUNTANT MEMBER

ITA No. 4695/Mum/2005 (A.Y.1999-2000)

M/s. United Phosphorus Limited, Mumbai
(Now known as Uniphos Enterprises Ltd.)
Uniphos House, 11-C.D. Marg
Opp. Madhu Park
Khar (W), Mumbai – 400 052
PAN: AAACU3440P

..... Appellant

Vs.

ACIT CC -2
Dy. Commissioner of Income Tax
Central Circle-38
Mumbai

..... Respondent

ITA No. 4699/Mum/2005 (A.Y.1999-2000)

ACIT CC -2
Dy. Commissioner of Income Tax
Central Circle-38
Mumbai

..... Appellant

Vs.

M/s. United Phosphorus Limited, Mumbai
(Now known as Uniphos Enterprises Ltd.)
Uniphos House, 11-C.D. Marg
Opp. Madhu Park
Khar (W)
Mumbai – 400 052
PAN: AAACU3440P

..... Respondent

Appellant by : Ms. Vasanti B Patel / Shri Kirit
Kamdar & Ms. Saisudha Multani
Respondent by : Shri Rajneesh Yadav
Date of hearing : 12/07/2023
Date of pronouncement : 20/09/2023

ORDER

PER GAGAN GOYAL, A.M:

These cross appeals by assessee and Revenue are directed against the order of Ld. CIT (A) – Central-VI, Mumbai dated 25/04/2005 u/s. 143(3) of the Income Tax Act, 1961 (in short ‘the Act’) for A.Y. 1999-2000. The assessee has raised the following grounds of appeal:-

I. TAXABILITY OF ADVANCE LICENCE BENEFIT RECEIVABLE Rs. 2, 11, 64,259/-

“1.1 On the facts and in the circumstances of the case and in law, the Commissioner of Income-tax (Appeals) erred in upholding the action of the Deputy Commissioner of Income-tax to include advance licence benefit receivable amounting to Rs. 2, 11, 64,259/-, in the total income, particularly as no income had accrued to the appellant until the imports were made and the raw materials were consumed, which events took place in the subsequent year.

1.2 In doing so, the Commissioner of Income-tax (Appeals) erred in not appreciating the fact that it is a well established legal proposition that entries in the books of account were not material for determining the tax liability and if no income had accrued, the same could not be taxed even though the said item was accounted for as income in the books of account.

II. TAXABILITY OF PASS BOOK BENEFITS RECEIVABLE: Rs. 16, 00, 23,119/-

2.1 On the facts and in the circumstances of the case and in law, the Commissioner of Income-tax (Appeals) erred in confirming the action of Deputy Commissioner of Income-

tax to include Pass Book benefit receivable amounting to Rs. 16,00,23,119/- in the total income.

2.2 In doing so, the Commissioner of Income-tax (Appeals) erred in not appreciating the fact that no income had accrued to the appellant until credit was received in the Pass Book, which event took place in the subsequent year and that it is a well established legal proposition that entries in the books of account were not material for determining the tax liability and if no income had accrued then the same could not be taxed even though the said item was accounted for as income in the books of account.

III PREMIUM ON SPECIAL IMPORT LICENCE Rs. 24, 00,000/-

3.1 on the facts and in the circumstances of the case and in law, the Commissioner of Income-tax (Appeals) erred in confirming the action of the Deputy Commissioner of Income-tax in taxing a sum of Rs 24, 00,000/- in respect of premium on special import licence credited to the Profit and Loss Account

3.2 In doing so, the Commissioner of Income-tax (Appeals) erred in not appreciating the fact that, only the profit on sale of licence is chargeable to tax and that the said licences were neither sold nor utilised during the relevant previous year,

IV. CLAIM FOR DEDUCTION IN RESPECT OF SALARY AND WAGES CAPITALISED IN THE ACCOUNTS Rs. 29, 94,085/-

4.1 On the facts and in the circumstances of the case and in law, Commissioner of Income-tax (Appeals) erred in confirming the action of the Deputy Commissioner of Income-tax In rejecting the appellants' claim for deduction in respect of salary and wages amounting to Rs.29, 94,085/- capitalised in the books of account without appreciating the fact that the said expenses represented revenue expenditure eligible for deduction under section 37(1)

V. INTEREST ATTRIBUTABLE TO EARNING OF EXEMPT INCOME

5.1 On the facts and in the circumstances of the case and in law, the Commissioner of Income-tax (Appeals) erred in confirming the action of the Deputy Commissioner of Income-tax of disallowing an amount of Rs 18, 46,485/- as expenditure incurred for earning tax free income without appreciating the fact that no expenditure had been incurred for earning such tax free income.

VI. DISALLOWANCE OUT OF INTEREST PAID: Rs. 56, 63, 041/-

6.1 On the facts and in the circumstances of the case and in law, the Commissioner of Income-tax (Appeals) erred in confirming the action of the Deputy Commissioner of Income-tax in disallowing an amount of Rs 56, 63,041/- out of interest paid by computing

notional interest income @ 18% and disallowing out of interest paid, the difference between the said notional interest computed @ 18% and the interest received.

6.2 The Commissioner of Income-tax (Appeals) further erred in confirming the action of the Deputy Commissioner of Income-tax in computing notional interest @ 18% without giving any justification or basis for the said rate.

VII. DEDUCTION UNDER SECTION 80-IA

7.1 On the facts and in the circumstances of the case and in law, the Commissioner of Income-tax (Appeals) erred in upholding the action of the Deputy Commissioner of Income-tax in computing the deduction under section 80-IA as follows:

(a) in reducing items of "other income" enumerated on page 21 of the aforesaid appellate order from the "profits and gains of the business, on the ground that the said income was not "derived from an industrial undertaking," without considering the costs, etc debited in the accounts in respect thereof and deducted while computing the profits of the industrial undertakings;

(b) in holding that items of other income like interest, refund of electricity duty, sales- tax refund, miscellaneous receipts, etc. were to be excluded without reducing the corresponding and matching costs which were deducted while computing the profits of the eligible undertakings;

(c) in not appreciating that if items of other income like interest, etc. were to be excluded, then only the net amounts ought to have been reduced while computing the profits of the eligible undertaking;

(d) in excluding the advance licence benefit receivable and the pass book benefit receivable from the profits and gains derived from the eligible undertakings.

7.2 On the facts and in the circumstances of the case and in law, the Commissioner of Income-tax (Appeals) erred in not appreciating the fact that "profits and gains derived from the business of an industrial undertaking" is eligible for deduction under section 80-IA and not only "profits and gains derived from an industrial undertaking" which is the wording in section 80-I.

7.3 On the facts and in the circumstances of the case and in law, the appellant further submits that if it is held that only income 'derived from the undertaking is to be included in the profits for the purpose of computing deduction under section 80-IA, the same norm should also apply to expenditure and accordingly expenditure which has no direct nexus with the undertaking ought not to be considered.

7.4 The Commissioner of Income-tax (Appeals) further erred in not giving any finding in respect of the issue that since the appellant had included the advance licence benefit reversal and the pass book benefit reversal as part of the cost of raw materials and in case the said benefits were excluded, the corresponding notional reversals also ought to have been removed from the cost for the purpose of working the profits of the eligible undertakings;

VIII. DEDUCTION UNDER SECTION 80HHC

8.1 On the facts and in the circumstances of the case and in law, the Commissioner of Income-tax (Appeals) erred in confirming the action of the Deputy Commissioner of Income-tax in holding that the deduction eligible under 80HHC(1) is not allowable as the profits derived from exports of goods computed under clause (c) of section 80HHC(3) has resulted in a negative figure by relying on the decision of the Bombay High Court in the case of IPCA Laboratories Ltd vs. CIT (No.1) (251 ITR 401).

The Commissioner of Income-tax (Appeals) further erred in not giving any finding in respect of the following issues:

(A) While computing the 'profit of the business' for the purpose of deduction under section 80HHC:

(i) in reducing 90% of the following items from the profits of the business in spite of the fact that the said items were not specifically required to be reduced from the profits of the business as per the definition given in clause (baa) of the Explanation below section 80HHC(4A):

Particulars	Rs. (lacs)
(i) Management service charges	422.50
(ii) Sales Tax Refund	26.93
(iii) Discount	34.71
(iv) Excess provision written back	140.25
(v) Exchange rate difference	94.55
(vi) Refund on electricity duty	60.81
(vii) Miscellaneous receipts	47.97

(ii) In not appreciating the fact that only the net amount of interest received by the appellant ought to have been reduced as per Explanation (baa) below section 80HHC(4A) and in view of the fact that as the appellant had credited in the Profit and Loss Account, an amount of Rs 369.02 lacs as interest received and had debited an amount of Rs.3,294.98 lacs as interest paid, the interest paid being more than the interest received, no portion of the interest received ought to have been reduced for the purpose of working out deduction under section 80HHC;

(iii) In not appreciating the fact that the word "receipts" as referred to in the Explanation (baa) below section 80HHC(4A) refers only to the net receipts and accordingly, gross receipts cannot be reduced from the profits of the business;

(B) In not considering the exclusion of unrealised sale proceeds and value of goods re-imported/ returned from the total turnover as claimed during assessment proceedings while computing the "total turnover" and "export turnover" for the purpose of deduction under section 80HHC

(C) In not recomputing the indirect cost of traded goods as claimed during assessment proceedings;

IX. PROPORTIONATE DEDUCTION IN RESPECT OF PREMIUM ON LEASEHOLD LAND Rs. 1, 84, 078/-

9.1 On the facts and in the circumstances of the case and in law, the Commissioner of Income-tax (Appeals) erred in upholding the action of the Deputy Commissioner of Income-tax of not allowing the claim for deduction of Rs. 1, 84,078/- in respect of proportionate premium paid on leasehold land over the period of the lease, as per the ratio of the decision of the Supreme Court in the case of Madras Industrial Investment Corporation Limited vs CIT (225 ITR 802).

X INTEREST UNDER SECTION 234D

10.1 On the facts and in the circumstances of the case and in law, the Commissioner of Income-tax (Appeals) erred in not appreciating the fact that section 234D has been inserted by the Finance Act, 2003 with effect from 1 June, 2003 and accordingly, interest under the said section could not be levied in respect of refunds granted prior to 1 June, 2003.

The appellant hereby reserves the right to add to, alter or amplify the above grounds of appeal"

2. The Revenue has raised the following grounds:-

1. *"On the facts and in the circumstances of the case and in law, the learned CIT(A) was not correct in treating Product Registration expenses of Rs. 1,37,93,917/- and Research & Development expenses of Rs. 3,89,70,006/- as revenue in nature."*

2. *"On the facts and in the circumstances of the case and in law, the learned CIT(A) was not correct in deleting the disallowance of Rs. 3,81,092 u/s 36(1)(va) and of Rs. 10,74,857 u/s 43B made by the Assessing Officer on account of provident fund contribution made beyond the due date of filing of return, without appreciating that Sec. 43B is an overriding provision and the due date as per the explanation given below clause (va) of Section 36(1) of IT Act, 1961 means the date by which the assessee was required to pay the provident fund under the P.F. Act and cannot be extended to mean the due date of filing of Return".*

3. *"On the facts and in the circumstances of the case and in law, the learned CIT(A) was not correct in deleting the disallowance of Rs. 2,59,186/- u/s. 43B made by the Assessing Officer on account of ESIC contribution made beyond the due date. He erred in holding that disputed payment made before the due date of filing of return without appreciating Sec 43B is an overriding provision and the due date as per explanation given below clause (va) of Section 36(1) of I.T. Act, 1961 means the date by which the assessee was required to pay the ESIC fund under the ESIC Act and cannot be extended to mean the due date of filing Return":*

4. *"On the facts and in the circumstances of the case and in law, the Ld. CIT(A) was not correct in deleting disallowance of Rs. 2,95,73,585/- on account of Legal Fees."*

5. *"On the facts and in the circumstances of the case and in law, the learned CIT(A) was not correct in deleting disallowance of Rs. 2,95,73,585/- on account of Legal Fees was treated as 'advance' in its books by the assessee".*

6. *"On the facts and in the circumstances of the case and in law, the learned CIT(A) was not justified in accepting the contention of the assessee with regards to Legal Fees without giving opportunity to the Assessing Officer under Rule 46A(3)".*

3. The brief facts of the case are that assessee filed its return of income declaring total income at Rs. 9,37,22,420/-. Return of the assessee was processed u/s. 143(1) of the Act, thereafter case of the assessee was re-opened u/s. 147 of the Act and notice u/s. 148 of the Act, dated: 27.03.2003 was issued. In response to this notice assessee filed its return of income declaring total income at Rs. 9,37,22,420/- again vide dated: 25.03.2003. On request of assessee reasons were

supplied and questionnaire u/s. 142(1) and 143(2) of the Act were issued. Case of the assessee was assessed at Rs. 16, 88, 13,010/- after various disallowances/additions made. Being aggrieved with this order of AO assessee preferred an appeal before the Ld. CIT (A)-Central-VI, Mumbai, who in turn passed an order u/s. 250 of the Act, allowing assessee's appeal in part. Against this order of Ld. CIT (A), assessee as well Revenue both are in appeal before us.

4. We have gone through the order of AO, order of Ld. CIT (A) and submissions of both the sides. First, we are taking assessee's appeal for adjudication and then Revenue's appeal. Assessee raised total as many as 10 grounds of appeal vide Form No. 36 filed. Assessee is engaged in the manufacturing of Phosphorus and its compounds, pesticides and intermediaries for local and export sales. Ground wise adjudication of matter is as under:

5. The first issue to be decided in this appeal of the assessee is with regard to taxability of advance license benefit receivable of Rs. 2,11,64,259/-. An amount of Rs. 2, 11, 64,259/- being the net benefit under the Import and Export Policy in respect of entitlement to import duty free raw materials was accounted by way of reduction from raw material consumption for the year ended 31st March 1999. In the return of income, the assessee excluded the aforesaid amount of Rs. 2, 11, 64,259/- being the net benefit under the Import and Export Policy in respect of entitlement to import duty free raw materials on the ground that the income has not accrued until the imports are made and raw material is consumed, which events had taken place in the subsequent year.

6. In assessment order (from para 5.11 to 5.12), it was held that the aforesaid income does not accrue till the goods are actually imported is not in conformity with the method of accounting on accrual concept. Hence the assessee's submission had been rejected and the aforesaid amount had been included in the total income.

7. The Id. CIT (A) had upheld disallowance made by the AO relying on the decision of ITAT in assessee's own case for AY 1995-96, 1996-97 and 1997-98.

8. Heavy reliance was also placed by assessee on the judgment of the Hon'ble Supreme Court in the case of CIT vs. Excel Industries Ltd (SC) (358 ITR 295). Further, the following decisions were also relied upon in the assessee's own case wherein the issue has been decided in favour of the assessee.

- a) Hon'ble Bombay High Court-AY 1994-95 (IT.A No. 1866 of 2013)
- b) Hon'ble Gujarat High Court-AY 1995-96 (Tax Appeal No: 322 of 2001)
- c) Hon'ble Gujarat High Court-AY 1997-98 (Tax Appeal No. 129 of 2003)
- d) ITAT-AY 1998-99 (ITA No. 1519/A/02) (Assessee's own case)

9. We have heard rival submissions and perused the materials available on record. The Hon'ble Supreme Court in the matter of Excel Industries Ltd (supra) held that value of any benefit or perquisite, arising from business or exercise of profession [Advance licence and duty entitlement pass book] until imports are actually made by assessee, benefits under advance license or under duty entitlement pass book represent only hypothetical income which cannot be

brought to tax. **In view of this, we decide the issue in favour of the assessee and ground no. 1 is allowed.**

10. Ground No. II is with regard to taxability of passbook benefit receivable of Rs. 16, 00, 23,119/-. An amount of Rs 16, 00, 23,119/- being accrued for the year ended 31st March 1999 under the Pass Book Scheme as per the Import and Export Policy was accounted as Export Incentives in the Profit and Loss Account. In the return of income, as stated in Note No. 6 of the notes to computation of total income filed with the original return, the assessee submitted that the benefit under the Import and Export Policy not credited in the Pass Book at the year end was not taxable on the ground that the income has not accrued until credit is granted in the Pass Book. In the assessment order it was held that the aforesaid income does not accrue until the credit is granted in the Pass Book is not in conformity with the method of accounting on accrual concept. The Id. CIT (A) in its order had upheld the disallowance made by the AO by relying on the decision of the ITAT in assessee's own case for AY 1990-91, 1997-98, 1998-99 and 2000-01 and the CIT(A)'s order for AY 2001-02. The aforesaid issue is covered in favour of the assessee by the decision of the Supreme Court in case of CIT vs. Excel Industries Ltd (SC) (358 ITR 295). Further, it was drawn to our attention the following decisions passed in the assessee's own case wherein the issue has been decided in the favour of the assessee.

- Hon'ble Gujarat High Court- AY 1997-98 (Tax Appeal No. 129 of 2003) (Assessee's own case)
- ITAT- AY 1998-99 (ITA No. 1519/A/02) (Assessee's own case)

11. We find that similar issue was decided in assessee's own case in ITA No.1519/Ahd/2022 wherein the Tribunal has decided the issue in favour of the assessee. We find in Tax Appeal No.129 of 2003, (Assessee's own case) Hon'ble High Court of Gujarat relying on the decision of Hon'ble Supreme Court in the case of CIT vs. Excel Industries Ltd (2013) 358 ITR 295 held that the Commissioner of Income-tax (Appeals) erred in not appreciating the fact that no income had accrued to the appellant until credit was received in the Pass Book, which event took place in the subsequent year and that it is a well established legal proposition that entries in the books of account were not material for determining the tax liability and if no income had accrued then the same could not be taxed even though the said item was accounted for as income in the books of account. **Respectfully following the same, ground No. II raised by the assessee is allowed.**

12. In Ground No.III assessee has raised an issue with regard to premium on special import licence of Rs. 24, 00,000/-. During the previous year relevant to the subject assessment year, the assessee credited a sum of Rs. 24, 00,000 to the profit and loss account in respect of the premium on special import licences, being the premium it expected to receive in respect of special import licences on hand as on 31 March 1999. It was submitted that since the said licences were not

sold and the amount booked was only an estimated notional figure, the same was reduced while computing the total income since as per the provisions of section 28(ia), only profit on sale of a licence granted under the Imports Control Order, 1955 is chargeable to tax. In the assessment order, it was held that the premium on special import licences shall be taxable only upon sale thereof is not in conformity with the method of accounting on the accrual concept. Hence the assessee's submission has been rejected and the premium on special import licence credited of Rs. 24, 00,000/- has been included in the total income.

13. In the CIT (A)'s order, disallowance made by the AO was upheld relying on the decision of the CIT (A) in assessee's own case for AY 1997-98 and 1998-99. The aforesaid issue is covered in favour of the assessee by the decision of the Supreme Court in case of CIT vs Excel Industries Ltd (SC) (358 ITR 295). Further, it was drawn to our attention the ITAT decisions passed in the assessee's own case for AY 1998-99 (ITA No. 1519/A/02) wherein the issue has been decided in the favour of the assessee.

14. The Tribunal in assessee's own case in ITA No.1519/Ahd/2002 has decided similar issue in favour of the assessee where the Tribunal held as under:-

"We have heard the rival submissions and perused the material before us. We directed the assessee to submit reconciliation chart showing the details of premium on special import license accounted in the books and amount offered to tax over the years. After considering, the reconciliation and the orders of the Tribunal, for the earlier AY.s. we are of the opinion that the FAA

was not justified in upholding the order of the AO. GOA-5 is decided in favour of the assessee”

15. Respectfully following the order of the Tribunal and following the judicial precedents, **we deem it fit to allow the ground No. 3 in favour of assessee.**

16. The Ground No. IV raised by the assessee was stated to be not pressed by the ld. AR. **We accordingly dismiss the said ground no. 4 as not pressed.**

17. Ground No. V relates to expenditure attributable to earning of exempt income of Rs. 16, 36, 570/-. During the previous year, the assessee received dividend Income amounting to Rs. 16,36,570/- which was claimed as exempt under section 10(33). The Dividend received from Indian subsidiaries was Rs. 6, 10,000/- and Dividend received from others was Rs. 10, 26,570/-. In the return of income, the assessee had not disallowed any expenditure under section 14A since no expenditure was incurred to earn the aforesaid income. The AO did not accept the contention of the assessee. Accordingly, in the assessment order, the AO computed proportionate Interest expense of Rs. 477.15 lakhs in respect of the total investment of Rs. 11,053.68 lakhs as attributable to earning exempt income. Since, the same was more than the dividend income, the disallowance under section 14A was restricted to dividend income of Rs. 16, 36,570/-.

18. In the Ld. CIT (A)'s order, relying on the appellate order for AY 2000-01, it was held that since the assessee has not been able to show the source from which

investments in shares were made, the AO cannot be faulted for taking the stand that some part of the borrowed funds must have been invested in acquiring the said shares. Therefore, the disallowance of interest of Rs. 16, 36,570 was held to be in order.

19. As on 31 March 1999, the assessee had own funds to the tune of Rs. 42,261.47 lakhs comprising of share capital of Rs. 4,347.47 lakhs and reserves and surplus of Rs. 37,914.00 lakhs. Further, investments from which dividend income was earned during the year amounted to Rs. 813.52 lakhs. Hence, the entire investments yielding dividend income has been made out of own funds.

20. The aforesaid fact has been confirmed by the Id. CIT(A) in para 11.6 of the appellate order, that interest free funds available with appellant were much more than sufficient to cover the investment made in shares yielding exempt dividend income.

21 Further, it was submitted that no borrowed/ interest bearing funds were used for the purpose of making of investments in shares yielding exempt income. Accordingly, no disallowance ought to be made in respect of interest expenditure. Further, there were no fresh investments made during the relevant previous year which have yielded dividend income.

22. In this regard, reliance was placed on the decision of the Hon'ble Supreme Court in the case of CIT vs. Reliance Industries Limited (2019] 102 taxmann.com 52 (SC) wherein it has been held that if the own funds of the assessee are higher

than the investments, then no disallowance ought to be made in respect of interest expenditure. The relevant extracts of the said decision are given below:

"7. The Hon'ble High Court has noted the finding of the Tribunal that the interest free funds available to the assessee were sufficient to moot its investment Hence, it could be presumed that the investments were made from the interest free funds available with the assesses. The Tribunal has also followed its own order for Assessment Year 2002-03.

8. In view of the above findings, we find no reason to interfere with the judgment of the High Court in regard to the first question. Accordingly, the appeals are dismissed in regard to the first question."

23. Further, reliance is placed on the below decisions:

(i) South Indian Bank Ltd. (438 ITR 1) (SC)

(ii) CIT vs HDFC Bank Ltd. (366 ITR 505) (Bom)

(iii) HDFC Bank Ltd vs DCIT (284 CTR 414) (Bom)

(iv). CIT vs. Reliance Utilities and Power Ltd (313 ITR 340) (Bom)

23. We have heard both the parties and found that the own funds Rs. 42,261.47 lakhs far exceed the investments in shares of Rs. 813.52 lakhs, no disallowance should be made in respect of interest expenditure attributable to earning dividend income. We have also relied upon the Judgment of Reliance Industries Limited (supra) wherein The Hon'ble High Court held that interest free funds available to the assessee were sufficient to moot its investment Hence, it could be presumed that the investments were made from the interest free funds available

with the assesses. **Respectfully following the judicial precedents, we decide the issue in favour of the assessee, accordingly, Ground No. V is allowed.**

24. With regard to Ground No.VI disallowance out of interest paid of Rs. 56, 63,041/-, During the relevant previous year, the total interest debited to the Profit and Loss Account amounted to Rs. 3,294.98 lacs The assessee also earned interest income on loans, deposits, etc. amounting to Rs. 369.02 lacs which was shown as part of Other Income in Schedule 'N' of the Annual Accounts. During the course of assessment proceedings, the assessee vide letter dated 17.03.2004 filed a detailed break-up and submissions in respect of items mentioned in Schedule 'K Loans and Advances. The assessee had given advances to Jai Research Foundation amounting to Rs. 56, 00,000/- on which the assessee earned interest of Rs. 7, 44,959/-. Further the assessee had given interest free lease rental deposits to following parties

1 Smt Shilpa Sagar Rs. 1, 00, 00,000/-

2 Shri Vikram Shroff Rs 1, 00, 00,000/-

3. Smt Sandra Shroff: Rs. 1, 00, 00,000/-

25. AO held that the assessee had advanced the aforesaid loans to its directors and their relatives and other concerns of the group. On these loans interest was charged at very low rate and in many of these cases no interest was charged and that these loans were not advanced to them for the purpose of business. Further, the AO disallowed an amount of Rs. 56, 63,041/- out of interest paid on the

ground that such interest was not paid wholly and exclusively for the purpose of the business. Notional interest at the rate of 18% was computed on the aforesaid advances and deposits and after deducting the interest received from the above parties, the balance was disallowed out of interest paid and added to the total income.

26. The computation of notional interest disallowed is as under:-

Sl. No	Name of the party	Principal amount (Rs)	Interest chargeable @18%	Actual interest received	Short recovery of interest
1	Smt. Shilpa Sagar	1,00,00,000/-	18,00,000/-	NIL	18,00,000/-
2	Sh. Vikram Shroff	1,00,00,000/-	18,00,000/-	NIL	18,00,000/-
3	Smt. Sandra Shroff	1,00,00,000/-	18,00,000/-	NIL	18,00,000/-
4	M/s Jal Research	56,00,000/-	10,08,000/-	7,44,959	2,63,041/-
	Total				56,63,041/-

27. In Ld. CIT (A)'s order, the CIT(A) upheld the disallowance made by the AO relying on the orders of the CIT(A) for AY 1997-98 and AY 2000-01. Further, the CIT(A) rejected the contention of the assessee that notional rate of 18% applied by the AO is excessive as compared to the actual average rate of interest payout

@ 12.17% since the assessee has not established the fact that the assessee has not paid interest at 16% or higher on any loan taken.

28. At the outset, it was submitted that the aforesaid loans, deposits and advances aggregating to Rs. 3,56,00,000/- were given in the earlier year out of the assessee's own funds and therefore no interest ought to be disallowed. In this connection, attention is invited to the Balance Sheet as on 31.03.1999. From the perusal of the Balance Sheet it can be seen that the Share Capital and Reserves and Surplus amount to Rs. 422.61 Crores whereas the total loans in respect of which disallowance of interest has been confirmed is Rs. 3.56 Crores only. Thus, it is evident that the appellant had sufficient interest free funds at its disposal for advancing the said loans and deposits.

29. We have heard both the parties at length and find that no part of the interest bearing funds have been utilized for advancing loans and accordingly, no interest should be disallowed as no borrowed funds were utilized for advancing the loans and deposits. We also relied upon the following judgments of Hon'ble Bombay High Court in ITA No.549 of 2017 and also following ITAT orders in assessee's own case for A.Y.1998-99 in ITA No.1519/A/02 and for A.Y.1997-98 in ITA No.4073/Mum/02. **Respectfully following the above the judgments of Hon'ble Bombay High Court and Tribunal Orders, we are allowing ground No.VI in favour of the assessee.**

30. With regard to issue of deduction u/s. 80-IA raised in Ground No.VII, In the assessment order passed under section 143(3) read with section 147 of the Act, it

was held that the items of other income aggregating to Rs. 1231.78 lakhs, advance licence benefit and passbook benefit are not derived from the industrial undertaking and are to be excluded from the profits while computing deduction under section 80-IA relying on certain judicial pronouncements. Accordingly, the AO computed deduction under section 80-IA at Rs. 7,41,95,991 as against deduction of Rs. 8,71,86,216 claimed by the assessee. In the appellate order passed by the Ld. CIT (A), the findings of the AO in respect of the following items have been upheld and it has been held that the same cannot form part of the profit and gains derived from eligible industrial undertaking as the immediate source of these receipts is not the industrial undertaking

(i) Interest on investment: Rs. 13.90 lakhs

(ii) Interest on loans and deposits. Rs. 369.02 lakhs

a. Interest from debtors -Rs. 166. 17 lacs

b. Interest from employees -Rs. 7.93 lacs

c. Interest from advance given for investments in preference shares of CIL-Rs. 27 70 lacs

d. Interest on Income-tax refund- Rs. 8.98 lacs

e. Interest on FDs and ICDs Rs. 158.24 lacs

(iii) Rent: Rs. 21.14 lakhs

(iv) Miscellaneous receipts Rs. 47.97 lakhs

(v) Sales tax refund: Rs. 26.93 lakhs

31. Further, in respect of the below receipts, the Ld. CIT (A) in para 13.6 & 13.7, has in principle agreed that the aforesaid items should be considered as part of the profits of the undertaking. However, the Ld. CIT (A) has upheld the exclusion of the aforesaid items from the profit of the undertaking on the ground that the appellant has not been able to prove the nexus of these items of income with a particular industrial undertaking

- i. Exchange difference: Rs. 94.55 lakhs
- ii. Discount: Rs. 34.71 lakhs (i)
- iii. Excess provision written back: Rs 140.25 lakhs
- iv. Management and service charges Rs. 422.50 lakhs
- v. Refund of electricity duty Rs. 60.81 lakhs

32. Similarly, the Id. CIT(A) relying on his own order for AY 2001-02 has held that advance license benefit receivable and pass book benefit receivable cannot be considered as part of profits and gains derived from an industrial undertaking for the purposes of section 80-IA.

33. Further, the Ld. CIT (A) held that net income (i.e. net of expenses) is to be reduced from the computation of deduction under section 80-IA However, he observed that it is necessary for the assessee to establish the direct nexus between the income and the expenses. Specific expenses which are directly incurred for earning particular item of income have to be identified and proved since, the assessee has not established such nexus, and the contention of the assessee was rejected.

34. We have heard both the parties at length on this ground. The items of income mentioned in para 31 & 32 are to be dealt separately for the purposes of section 80 IA based on the submissions of the assessee and settled legal position. In view of this each item for the purposes 80 IA, we are giving our separate and specific findings as under for items enumerated vide para 31 (supra):-

(i) Interest on investment : Rs. 13.90 lakhs - **This ground is not pressed, hence dismissed.**

(ii) Interest on loans and deposits : Rs. 369.02 lakhs.

a. Interest from debtors – Rs. 166.17 lacs

b. Interest from employees – Rs. 7.93 lacs

In respect of interest earned from debtors and interest from employees, it is submitted that it is inextricably linked to the business of the eligible undertakings.

In this regard, reliance is placed on the following decisions:

CIT vs Nirma Ltd (367 ITR 12) (Guj)

CIT vs Advance Detergents Ltd (339 ITR 81) (Del)

Considering the above judicial pronouncements on the subject matter (supra), we are in agreement that item no. (a) & (b) of serial no. (II) are eligible for the purposes of section 80 IA, hence the same are allowed.

c. Interest from advance given for investments in preference shares of CIL - Rs. 27.70 lacs – **This ground is not pressed, hence dismissed.**

d. Interest on Income-tax refund-Rs.8.98 lacs - **This ground is not pressed, hence dismissed.**

e. Interest on FDs and ICDs Rs.158.24 lacs ICD's.

35. Further, in respect of interest earned from FDs and ICDs, it is submitted that it is inextricably linked to the business of the eligible undertaking and hence, the same is derived from the business of the undertaking. In this regard, reliance is placed on the following decisions: 7.8. In this regards, reliance is placed on the decision of Bombay High Court in case of Ms. Tema Exchangers Manufactures Pvt. Ltd vs ACIT (ITA No. 415 of 2004) (Bom) (Unreported) wherein it was held as under.

4. Mr. Subramaniam, learned Counsel appearing in support of the appeal points out that Pandian Chemicals Ltd. (supra) was rendered in the context of Section 80HH of the Act and we are concerned with Section 80IA of the Act. It is particularly pointed out that there is a difference in the wording of the two sections as existing during the previous year relevant to the subject assessment year. Section 80HH of the Act grants deduction in respect of the profits and gains derived from industrial undertaking while Section 80IA of the Act as in force at the relevant time grants deduction of profits and gains derived from any business of an industrial undertaking. It is submitted that the above issue is no longer res integra as the issue stand concluded in its favour by the decision of this Court in Commissioner of Income Tax Vs. Jagdishprasad M.Joshi, 318 ITR 420.

5...

6. This Court answered the question in the affirmative while dismissing the Revenue's appeal. This by holding that income earned by the assessee on the fixed deposit from the bank has to be extended deductions under Section 80IA of the Act. In support of the above, this Court relied upon the decision of

the Delhi High Court in Commissioner of Income Tax Vs. Eltek SGS P. Ltd., 300 ITR 06 wherein the difference in the language employed in Sections 801B and 80HH of the Act was brought out i.e. "profits and gains derived from industrial undertakings" as found in Section 80HH of the Act with "profits and gains derived from any business of an industrial undertakings". In view of the difference in language of the two Sections, this Court held that interest on fixed deposits in the bank would be profits and gains derived from any business of an industrial undertaking. The same reasoning would apply to extend deductions under Section 80IA of the Act for the compensation received for non supply of spare parts. Thus, the issue stands concluded in favour of the assessee by the decision of this Court in Jagdishprasad M. Joshi (supra)

Relying on above judicial pronouncements of Hon'ble Jurisdictional High Court in the case of M/s Tema Exchangers (supra), **we respectfully follow the same, hence interest on FD's and ICD's are eligible for the purposes of section 80 IA.**

(iii) Rent: Rs. 21.14 lakhs

The aforesaid issue is covered in favour of the appellant by the decision of ITAT for AY 1998-99 (ITA No. 1519/A/02) (Para 12.2.3) passed in the appellant's own case (refer compilation page no. A190-A191A). **Respectfully following the decision of Coordinate Bench in AY 1998-99, rent of Rs. 21.14 lakhs is found to be eligible for the purposes of section 80 IA.**

(iv) Miscellaneous receipts: Rs. 47.97 lakhs

The aforesaid issue is covered in favour of the appellant by the decision of ITAT for AY 1998-99 (ITA No. 1519/A/02) (Para 12.2.3) passed in the appellant's own case (refer compilation page no. A190- A191A). **Respectfully following the**

decision of Coordinate Bench in AY 1998-99, Miscellaneous receipts of Rs. 47.97 lakhs is found to be eligible for the purposes of section 80 IA.

(v) Sales tax refund: Rs. 26.93 lakhs

7.11. In this connection, it is submitted that sales tax paid pursuant to the sales tax assessment on account of non-availability of 'C' Form from registered dealers is debited to profit and loss account and allocated to the undertakings in the proportion of turnover. During the year under consideration, on appeal, the appellant received refund of aforesaid sales tax paid, on the basis of the subsequent receipt of 'C' Forms from the registered dealers. Accordingly, it is submitted that the aforesaid income is just a refund of sale tax liability paid during the assessment. Further, such sales tax refund is also allocated to respective undertaking in the proportion of turnover. Therefore, the aforesaid items of income ought not to be excluded while computing the profit of the eligible undertaking.

36. However, in the appellate order passed by the ITAT for AY 1997-98 (ITA 4073/M/2003) (para 2-6), it was held as under:

"There is credit available in the sale tax account with the assessee, but it may be additional income for assessee as assessee could not reconcile the sale tax dues payable to the Government Account. Therefore, it is a surplus available to the assessee which assessee has declared it as additional income. However, this additional income is not out of any subsidy or scheme of Government to be considered as a part of business income which can be classified as income from eligible business. Therefore, the plea of assessee is not acceptable."

This claim of assessee for sales tax refund amounting to Rs. 26.93 lakhs are not found to eligible for the purposes of section 80 IA. As the same is part of assessee's liability for sales tax and in no way related to the unit /undertaking eligible for 80 IA. Same can be business income /expense for the purposes of

Income Tax Act as per section 28/37 of the Act, but the same cannot be attached to section 80 IA for the purposes of deduction.

37. Now we are taking up the issues enumerated in para 32 (supra) with a specific findings for each head as under:-

Reducing items of other income (at para 32 above) from 'profits of the eligible undertakings' on the ground the same do not have a direct nexus with the profits of the industrial undertaking in spite of corresponding costs being included:

- (i) Exchange difference: Rs. 94.55 lakhs
- (ii) Discount: Rs. 34.71 lakhs
- (iii) Excess provision written back: Rs. 140.25 lakhs
- (iv) Management and service charges: Rs. 422.50 lakhs
- (v) Refund of electricity duty: Rs. 60.81 lakhs

It is submitted that all the aforesaid items are mere recoupment of costs which go to reduce the cost of production. The corresponding costs of the above items have been considered while computing the profits of the eligible business undertaking. Therefore, the aforesaid items of income which represent recoupment of costs ought not to be excluded while computing the profit of the eligible undertaking.

In this connection, reliance is placed on the following decisions:

- (a) CIT vs Meghalaya Steels Ltd (383 ITR 217)(SC)
- (b) ACIT vs. Maxcare Laboratories Ltd. (92 ITD 11) (Cuttack)
- (c) ACIT vs Vinati Organics Ltd (36 CCH 123) (Mum)
- (d) ACIT vs Prakash L Shah (115 ITD 167) (Mum SB)

38. Further, it is submitted that the Ld. CIT (A) has in principle agreed that the items at para 32 above should be considered as part of the profit of the undertaking. However, the Ld. CIT (A) has upheld the exclusion of the aforesaid items from the profit of the undertaking on the ground that the appellant has not been able to prove the nexus of these items of income with particular industrial undertaking.

39. In this connection, it is submitted that the aforesaid items have been allocated to the various industrial undertakings on the basis of the turnover ratio. It may be noted that the overhead expenses incurred by the company have also been allocated to the respective industrial undertakings in the same ratio even though there was no direct nexus established and which method has been accepted by the Department. Accordingly, it is submitted that the aforesaid basis of allocation of aforesaid items of income based on the turnover ratio ought to be accepted and the said items of income ought to be included in the profits of the eligible undertaking.

40. Further, gist of the decisions relied upon in respect of the abovementioned items of other income are as under:

(i) Exchange rate difference Rs. 94.55 - ACIT vs Vinati Organics Ltd [2013] 36 CCH 123 (Mum)

(ii) Discount-Rs. 34.71

ITAT-AY 1998-99 (ITA No. 1519/A/02)

ITAT AY 1996-97 Para 40-41 (ITA No. 1303/A/2002)

ITAT AY 1997-98 (ITA No. 4073/Mum/02)

(ii) Excess provision written back Rs.140.25 – ITAT: AY 1998-99 (ITA No. 1519/A/02)

(iv) Management service charges Rs. 422.50 – ACIT vs. Maxcare Laboratories Ltd. (92 ITD 11) Cuttack) & CIT vs Meghalaya Steels Ltd (383 ITR 217) (SC)

(v) Refund of electricity duty- - Rs. 60.81 - ITAT-AY 1998-99 (ITA No. 1519/A/02) & ITAT - AY 1997-98 (ITA No. 4073/Mum/02)

(c) Not restricting the disallowance of 'other income' to net amounts:

41. It is submitted that if the items of 'Other Income' are to be excluded then only the net amount ought to be excluded while computing the profits of the eligible undertaking. In this connection, reliance is placed on the decision of the Supreme Court in the case of ACG Associated Capsules Pvt. Ltd vs. CIT (343 ITR 89).

(d) In case of exclusion of the aforesaid incomes holding that they have no nexus with the undertaking then the expenditure which does not have any direct nexus with the undertaking ought not to be considered while computing profits.

42. In this connection reliance is placed on the decision of the Bombay High Court in the case of Zandu Pharmaceuticals Works Ltd vs. CIT [2013] (31 Taxmann.com 191) (Bom) wherein it has been held as under:

"13. The Supreme Court held that there must be for the application of the words "derived from" a direct nexus between the profits and gains and an industrial undertaking. Sections 80-1 and 80-IA also use the expression "derived from". If there must be a direct nexus between the profits and gains and an industrial undertaking, it must follow equally that there must be a direct nexus between an industrial undertaking and the expenses which are sought to be apportioned/attributable to it. Expenses which do not relate to an industrial undertaking/unit under consideration and they relate to other units or to the head office of the assessee, cannot be taken into consideration while computing the deduction under the said provisions."

43. The head of income mentioned at serial no. 2, 3 & 5 are discussed by Coordinate bench in assessee's own case and decided in their favour. As the department is not able to controvert the ratio laid down by the Coordinate Bench and not able to distinguish the same, we respectfully follow the same and found to be eligible for the purposes of 80 IA. As far as item no. 1 and 4 are concerned, same has been discussed in the case of Vinati Organics and Meghalaya Steels Ltd. (supra). The facts of the case and ratios laid down in Vinati Organics and

Meghalaya Steels Ltd. are identical, hence found to be eligible for purposes of section 80 IA.

44. Ground no. VIII pertains to deduction under section 80HHC. In the revised return of income, the appellant claimed deduction under section 80HHC amounting to Rs. 4, 27, 96,578/- as per the Audit Report under section 80HHC (4) of the Act. In para 13.5 to 13.7 of the assessment order, the deduction under section 80HHC was computed at Rs. Nil after making certain adjustments. Further, deduction eligible under the proviso to section 80HHC (3) in respect of 90% of the export incentives was also not granted and deduction under section 80HHC was computed at Rs. Nil by holding that the deduction under section 80HHC is not allowable once the profits derived from export of goods computed under clause (c) of section 80HHC (3) is negative by relying on the decision of the Bombay High Court in the case of IPCA Laboratories Ltd vs CIT (No.1) (251 ITR 401).

45. The various issues raised in the appeal are as under:-

(a) Deduction eligible under section 80HHC (1) is not allowable as the profit derived from export of goods computed under clause (c) of section 80HHC (3) is negative

It is submitted that the deduction under section 80HHC ought to be recomputed in view of the amendment by the Taxation Laws (Amendment) Act, 2005 with retrospective effect from 1 April, 1992. The appellant had raised the following grounds in respect of the reduction of 90% of the items of other income from 'profits of the business' before the Ld. CIT (A):

(b) Reduction of 90% of the following income from 'profits of the business':

(i) Management service charge

(ii) Sales tax refund

- (iii) Discount
- (iv) Excess provision written back
- (v) Exchange rate difference
- (vi) Refund on electricity duty
- (vii) Miscellaneous receipts

46. However, in the appellate order passed by the CIT(A) no finding has been given in respect of the aforesaid issues. It is submitted that all the aforesaid items are mere recoupment of costs which go to reduce the cost of production. The corresponding costs of the above items have been considered while computing the profits of the business under section 80HHC. Therefore, the aforesaid items of income which represent recoupment of costs ought not to be excluded while computing the profit of the business under section 80HHC.

47. It is further submitted that in determining the profits of the business for the purposes of sub-clause (baa) of the explanation to section 80HHC (4), the incomes which are susceptible to a reduction of ninety percent are those which are specifically prescribed by the legislature. These are inter alia the incomes referred to in clauses (ilia), (b) and (iiic) of section 28 and receipts by way of brokerage, commission, interest, rent, charges or receipts of a similar nature included in such profits. Therefore, before a receipt is liable to be excluded to the extent of ninety per cent, it must be a receipt of a nature similar to brokerage, commission, interest, rent or charges. Management service charges do not constitute a receipt of a similar nature within the meaning of explanation (baa) and accordingly, not liable to be reduced to the extent of ninety percent from the profits of the business.

48. It is submitted that the aforesaid incomes are part of business income and are not in the nature of rent, brokerage, commission, interest and charges. Accordingly, 90% of items of the other income ought not to be reduced from the

eligible profits for the purpose of computation of deduction under section 80HHC. In this connection, reliance is placed on the following decisions:

Sr. No.	Particulars	Decisions in favour of assessee
i.	Management service charges Rs.422.50	ITAT - AY 1998-99 (ITA No. 1519/A/02) Para 11.3
ii.	Sales-tax refund - Rs.26.93	ITAT - AY 1995-96 (ITA No. 1516/A/2002), Para 17.4
iii.	Discount-Rs.34.71	ITAT - AY 1998-99 (ITA No. 1519/A/02) Para 11.3
iv	Excess provision written back Rs. 140.25	ITAT - AY 1995-96 (ITA No. 1516/A/2002), Para 17.4
v	Exchange rate difference Rs.94.55	(a) CIT vs. Amber Exports (India) (326 ITR 455) (Bombay) (b) Smt. Sujata Graver vs. DCIT (74 TTJ 347) (Delhi)
vi	Refund on electricity duty Rs.60.81	ITAT-AY 1995-96 (ITA No. 1516/A/2002), Para 17.4
	Miscellaneous Receipts Rs.47.97 Receipts	(a) ITAT - AY 1995-96 - ITA No. 1516/A/2002, Para 17.5 (b) ITAT - AY 1998-99 (ITA No. 1519/A/02), Para 11.3 (c) ITAT - AY 1997-98 (ITA No. 4073/Mum/02), Para 22-25.

(c) Reduction of only the net amount of interest received as per Explanation (baa) to section 80HHC (4A):

49. It is submitted that only the net amount of interest received ought to be excluded from the profits of the business as per Explanation (baa) below section 80HHC (4A). In support of the above contention, reliance is placed on the decision of the Hon'ble Apex court in case of ACG Associated Capsules Pvt. Ltd vs. CIT (343

ITR 89). Attention is further invited to the following decisions passed by the ITAT in the assessee's own case:

a) AY 1994-95-ITA No. 184/Ahd/1998 (Para 38-39 at page A142 of the Paper-book Volume II)

b) AY 1995-96-ITA No. 1516/Ahd/2002 (Para 17.7 at page A122 of the Paper-book Volume II)

c) AY 1998-99-ITA No. 1519/A/02 (Para 11.3.4 at page A185-186 of the Paper-book Volume II)

(d) Gross receipts cannot be reduced from the profits of the business:

50. It is submitted that word 'receipts' as referred to in the Explanation (baa) below section 80HHC(4A) refers only to the net receipts and accordingly, gross receipts cannot be reduced from the profits of the business. In support of the above contention, reliance is placed on the decision of the Hon'ble Apex court in case of ACG Associated Capsules Pvt. Ltd vs. CIT (343 ITR 89). Attention is further invited to the following decisions passed by the ITAT in the assessee's own case:

a) AY 1994-95-ITA No. 184/Ahd/1998 (Para 38-39 at page A142 of the Paper-book Volume II)

b) AY 1995-96-ITA No. 1516/Ahd/2002 (Para 17.7 at page A122 of the Paper-book Volume II)

c) AY 1998-99-ITA No. 1519/A/02 (Para 11.3.5 at page A185-A186 of the Paper-book Volume II)

d) AY 1997-98-ITA No. 4073/Mum/2003 (Para 25 at page A219 of the Paper-book Volume II)

(e) Not-exclusion of unrealized sale proceeds and value of goods re-imported / returned from computation of total turnover

Unrealized sale proceeds:

It submitted that since aforesaid sales proceeds are not realised, the same shall be excluded from the total turnover. In support of the above contention, reliance is placed on the decision of the Kerala High Court in case of CIT vs. Abad Fisheries (258 ITR 641) (Ker).

Value of goods re-imported/returned

It is submitted that since the goods have been returned, the same shall not be considered as a part of total turnover.

(f) Not recomputing the Indirect cost of traded goods as claimed in the assessment proceedings

It is submitted that the 10% of expenses deemed to be incurred for earning income which has been reduced to arrive at the Profits of the Business ought to be reduced while computing the indirect cost of traded goods. In support of the above contention, reliance is placed on the decision of the Supreme Court in case of Hero Exports Vs. CIT (295 ITR 454) (SC).

51. In view of above ground No. 8 raised by the assessee is allowed.

52. Ground no. 9 pertains to proportionate deduction in respect of premium on leasehold land Rs. 1,84,078/-. During the previous year relevant to AYs 1992-93, 1993-94, 1995-96 and 1997-98, the assessee had paid premium on leasehold land amounting to Rs. 57,71,750/-, Rs. 22,88,579/-, Rs. 11,01,70,905/- and Rs. 66,33,625/- respectively. The said amounts were claimed as a deduction in the returns of income for the said years. In the assessment orders passed under section 143(3) for the aforesaid years, the assessee's claim that the entire

premium on leasehold land should be allowed as a deduction had been disallowed. Accordingly, the assessee claimed that proportionate deduction in respect the premium paid be allowed over the period of the lease.

53. We heard the rival submissions and find that the claim for deduction of the entire premium paid on leasehold land during the earlier years i.e. AY 1995-96 and AY 1997-98 has been allowed in the year of payment. Since the entire premium paid has been allowed as a deduction in the year of payment itself, **the claim for allowing proportionate premium over the lease period is now infructuous and therefore not pressed.**

54. Ground no. 10 pertains to interest u/s. 234D. An amount of Rs. 41, 57,430/- was refunded to the assessee vide refund order dated 28 March 2000. The said refund comprised prepaid taxes amounting to Rs. 37,11,997 and interest thereon under section 244A amounting to Rs. 4,45,433/-. In the assessment order passed, the refund due has been determined at Rs. Nil and interest under section 234D of Rs. 37,11,997 had been levied.

55. We heard the rival submission and find that as per Explanation 2 inserted vide Finance Act, 2012, it has been declared that the provisions of section 234D as inserted vide Finance Act 2003 shall also apply to the assessment year commencing before 1 June 2003 if the proceedings of such assessment year is completed after the insertion of section 234D. **This ground of appeal is not pressed, hence dismissed.**

56. **In the result the appeal of the assessee is partly allowed.**

ITA No. 4699/Mum/2005 (AY 1999-2000)

57. The revenue has raised the following ground of appeal:-

1. *"On the facts and in the circumstances of the case and in law, the learned CIT(A) was not correct in treating Product Registration expenses of Rs.*

1,37,93,917/- and Research & Development expenses of Rs. 3,89,70,006/- as revenue in nature."

2. "On the facts and in the circumstances of the case and in law, the learned CIT(A) was not correct in deleting the disallowance of Rs. 3,81,092 u/s 36(1)(va) and of Rs. 10,74,857 u/s 43B made by the Assessing Officer on account of provident fund contribution made beyond the due date of filing of return, without appreciating that Sec. 43B is as overriding provision and the due date as per the explanation given below clause (va) of Section 36(1) of I.T. Act, 1961 means the date by which the assessee was required to pay the provident fund under the P.F. Act and cannot be extended to mean the due date of filing of Return".

3. "On the facts and in the circumstances of the case and in law, the learned CIT(A) was not correct in deleting the disallowance of Rs. 2,59,186/- u/s. 43B made by the Assessing Officer on account of ESIC contribution made beyond the due date. He erred in holding that disputed payment made before the due date of filing of return without appreciating Sec 43B is an overriding provision and the due date as per explanation given below clause (va) of Section 36(1) of I.T. Act, 1961 means the date by which the assessee was required to pay the ESIC fund under the ESIC Act and cannot be extended to mean the due date of filing Return".

4. "On the facts and in the circumstances of the case and in law, the Ld. CIT(A) was not correct in deleting disallowance of Rs. 2,95,73,585/- on account of Legal Fees."

5. "On the facts and in the circumstances of the case and in law, the learned CIT(A) was not correct in deleting disallowance of Rs. 2,95,73,585/- on account of Legal Fees was treated as 'advance' in its books by the assessee".

6. "On the facts and in the circumstances of the case and in law, the learned CIT(A) was not justified in accepting the contention of the assessee with regards to Legal Fees without giving opportunity to the Assessing Officer under Rule 46A(3)..

58. Ground no. 1 pertains to allowing product registration expenses of Rs. 137,93,917/- and research and development expenses Rs. 389,70,006/- as revenue in nature by the Ld. CIT (A).

59. In the accounts for the relevant previous year the said expenses were treated as deferred revenue expenditure. In the computation of total income, the deferred revenue expenditure amounting to Rs. 1, 95 ,04,164/-debited to the Profit and Loss Account was added back and deduction amounting to Rs. 5,27,68,923/--in respect of the aforesaid expenditure incurred during the year was claimed. In Note No. 12 of the notes to computation of total income filed alongwith the original return of income, it was submitted that since the said expenditure was incurred during the relevant previous year and constituted revenue expenditure, it was eligible for deduction under section 37(1) of the Act.

60. It was explained that the company had incurred expenditure of Rs 3.89 crore during the relevant previous year on R&D which was treated as deferred revenue expenditure in the books of account and amortised over a ten year period. In the computation of income the entire expenditure of Rs 3.89 crore was claimed as deduction as the same had been incurred to improve and test the existing products of the company and for developing new products and testing them to meet the market requirements. It was urged that this was not capital expenditure and it had been laid out on scientific research related to the business and so was allowable u/s. 35(1) (i) of the Act. Alternatively, the said expenditure was also allowable u/s. 37(1) Without prejudice to the contention that the said

expenditure was on revenue account, it was content that even capital expenditure on scientific research related to the business of the assessee is allowable as deduction u/s. 35(2)(ia) in the year in which such expenditure is incurred.

61. In respect of registration expenses of Rs. 137, 93,917/-, Ld. CIT (A) has observed as under:-

The appellant submits that the Product Registration Expenditure was actually incurred during the year under consideration. It is urged that liability to tax cannot be decided on the basis of entries in the books of account, but has to be decided in accordance with the provisions of law. It is contended that the said expenditure is allowable u/s 37 of the Act. Reliance has been placed on decisions of the High Courts and also of the Supreme Court in the case of CIT vs. Shoorji Vallabhdas & Co. 46 ITR 144, Kedarnath Jute 82 ITR 363; Chowringhee Sales Bureau 87 ITR 542; Berger Paints 254 ITR 503. It is submitted that the registration of the product was compulsory to make sales in the respective countries. Without such registration, the appellant company could not have launched its product for sale in those countries. The expenditure was, therefore, of revenue nature. It is submitted that similar expenditure was allowed upto A.Y. 1996-97. Disallowance was made for the first time in AY 1997-98 and the same was deleted by CIT (A) and Department's appeal was dismissed by the ITAT.

62. **In view of the above, we respectfully follow the findings of coordinate bench in assessee's own case and sustain the findings of Ld. CIT (A) plea raised by the revenue as far as product registration expenses of Rs. 137,93,917/- is concerned.**

63. In respect of research and development expenses Rs. 3,89,70,006/-, the Coordinate Bench of ITAT in ITA No. 4073/Mum/2023 for AY 1997-98 and ITA No. 1519/Ahd/2002 for AY 1998-99 has decided this ground in favour of assessee and allowed the expenses on proportionate basis. We also respectfully follow the same and direct the AO to allow the same on same basis. **To that extent order of Ld. CIT (A) is modified and ground raised by the revenue is partly allowed as far as research and development expenses Rs. 389, 70,006/- is concerned.**

64. Ground no. 2 and 3 pertains to disallowance of Rs. 3,81,092/- u/s. 36(1)(va), Rs. 10,74,857/- u/s. 43B and Rs. 2,59,186/- u/s. 43B made by the Assessing Officer on account of ESIC contribution made beyond the due date made by AO on account of provident fund and ESIC contribution made beyond the due date of filing of return and due date of respective laws respectively.

65. As far as employee's share of PF and ESIC is concerned, same has to be deposited before the due dates as defined in respective laws, these are not being governed by section 43B, hence the benefit as claimed by the assessee that the same has been deposited before the due date for filing of return u/s. 139(1) is not tenable. Hence, the same is disallowed and order of AO is confirmed on this aspect. As far as employer's share in PF and ESI is concerned, same is being governed by the provisions of section 43B and assessee can take advantage of the same by depositing before the due date as prescribed for filing of return u/s 139(1). This position is now being settled by the Hon'ble Apex Court in the case of **CHECKMATE SERVICES P. LTD Vs. COMMISSIONER OF INCOME TAX-1 (CIVIL**

APPEAL NO. 2833 OF 2016). In view of this, ground no. 2 & 3 raised by the revenue is partly allowed.

66. Ground no. 4 pertains to allowing legal fee amounting to Rs. 2, 95, 73,585/-. In ground No 4 of appeal the revenue has challenged the decision of Ld. CIT (A) allowing, disallowance of claim for deduction of legal fees of Rs. 2,95,73,585/-, which in the accounts had been treated as an advance. During the previous year relevant to the assessment year under consideration, the appellant paid an amount of Rs. 2, 95, 73,585/- as legal fees to various Attorneys/Advocates for suits filed by the assessee company abroad. In accounts this amount of legal fees was treated as advance. In Note No. 16 of notes to computation of total income filed with the original return, it was contended that since the legal fees was paid during the previous year relevant to the assessment year under consideration, the same was to be allowed as deduction. During the course of assessment proceedings, the appellant furnished the bills raised by the foreign attorneys along with the necessary evidence of remittance of payment to the Foreign Attorneys. Through bank against the said bills and justified the claim for deduction vide letter dated 17.3.2004.

67. The assessing officer observed that the payment of the fees in question had been shown in the accounts as advance payment. He held that liability for the legal fees would crystallize when final bills are submitted to the assessee. The AO has stated that the assessee did not furnish evidence regarding the nature of the suits filed, the structure of fees to be paid to the attorneys, the nature of liability

arising in connection with the said suits filed etc. The AO noted that similar disallowances made in A.YS 1998-99 and 2000-01 had been confirmed by the Ld. CIT (A). Following the decision of CIT (A) for AY 2000-01 the AO disallowed the claim for deduction. In appeal it is urged that the appellant company has filed suits against various parties claiming damages from them amounting to approximately US \$ 60 million. The attorney's fees paid during the year were mainly on the following three suits:

- I. United Phosphorus Ltd. (UPL) vs. Angus (USA) Angus Chemicals, a US company, was the only manufacturer of intermediate Amino Butanol which is used for anti TB drug. UPL developed its own know how with a different route for manufacture of this product. Thereupon UPL applied to the Central Government for license to manufacture this product. As the news broke Angus filed a suit against UPL to stop UPL from entering the Amino Butanol market and also claimed heavy damages of US \$ 25 million on the ground that UPL has stolen know-how for manufacture of Amino Butanol. Angus was successful in getting injunction against UPL restraining UPL from commencing production of Amino Butanol. No damages were immediately levied on UPL but if UPL had not contested the matter damages would have been levied for US \$ 25 million or more. Accordingly, UPL challenged the injunction on the ground that it had developed know how for manufacture of this product through a route and process which was entirely different from that of Angus. As UPL pressed its case in the court, Angus Chemicals withdrew the suit filed by

- them against UPL unilaterally, but the same was done after almost 20 months of litigation. However, at the time of withdrawing the suit Angus expressly reserved the right to revive the case in future if it so desired. It was therefore felt necessary by UPL to fight the case till the end .Hence UPL filed a case against Angus Chemicals for claiming damages for loss of business on account of unlawful injunction obtained by Angus Chemicals and for violation of Anti Trust Laws, which are somewhat similar to MRTP Act in India. This was resisted by Angus Chemicals and many technical objections were raised. The matter is still before the US Court.
- II. United Phosphorus vs. Midland. Midland Fumigant, a US company, held registrations for the product Aluminium Phosphide. This company engaged in business malpractices. It used to purchase cheap and inferior quality Aluminium Phosphide from China and put the label of UPL on the container thereby making out that they were selling the superior quality Aluminium Phosphide manufactured by UPL which was much in demand in the USA. Upon discovery of this malpractice UPL filed a suit against Midland Fumigant for unlawful use of UPL's labels. The matter was decided in favour of UPL and damages were awarded by the Court.
 - III. Case in USA against GREENPEACE. When UPL imported second hand Chlore Alkali plant from Norway in the year 1995, Green Peace alleged in an article that this plant will cause immense pollution in Gujarat and that UPL, in violation of international conventions, had imported dirty technology in India. However, the fact was that the plant imported at a

cost of Rs. 165 Crores was a state of the art plant and the technology was absolutely modern. This was informed to Green Peace. However, they did not retract their statement. The Company therefore filed a defamation suit in the US court and claimed damages. The company received US \$ 2, 00,000 from Green Peace in this matter.

68. It is submitted that during the relevant previous year, the following payments have been made against the bills received from the foreign attorneys for prosecuting the abovementioned suits:

1. Midland case	Rs. 1,72,42,677/-
2. Greenpeace case	Rs. 14,69,318/-
3. <u>Angus case</u>	<u>Rs. 1,08.61,590/-</u>
Total	Rs. 2, 95, 73,585/-

69. It is reiterated that the relevant bills and supporting for payments made alongwith note on allowability of legal fees had been submitted during the assessment proceedings vide letter dated 17th March, 2004. The bill wise details of payments made during the year are furnished as under:

Page No of paperbook	Amount in Rs.	Amount in US \$	Paperbook No. referring bill amount	pg. bill	Less: Discount	Amount in US \$
170 -182	240,510	5,638		178		1,945
				182		3,693
						5,638
183-185	699,741	16,369		183		16,369
186-188	887,249	20,755		186		20,755
189-191	1,081,718	25,305		189		25,305
192-217	1,637,725	38,343		204		22,422
				213		12,695
				218		3,226
						38,343
218-233	1,254,495	29,434		228		13,813
				233		15,622
						29,434
234-235	3,523,462	82,672		234		82,672
236	3,538,762	83,089		236		83,089
237-269	3,131,251	73,469		265		77,048
					@10%	7,705
						69,343
				268		4,126
						73,469
270-307	3,765,906	88,422		301		80,052
					@10%	8,005
				307		72,047
						16,376
						88,422
308-345	2,165,524	50,858		322		5,944
				325		2,797
				333		17,892
				345		11,284
						37,916
					@10%	3,792
						34,124
				322		529
				325		22
				334		16,009
				345		174
						50,858
425	544,271	13,109		425		13,109
426	769,577	18,598		426		18,598
427	2,117,500	50,000		427		50,000
346-351	4,215,893	99,502		347		99,502
	29,573,585					

70. It is submitted that in the books of accounts the above payments have been treated as advances to foreign attorneys and shown under the head "Loans and Advances" to be adjusted when the court finally decides the said suits. It is pointed out that during the previous year relevant to assessment year 2001 -02 the case against Midland and GREENPEACE was decided and the company was awarded damages amounting to Rs. 11,15,01,716/- against which expenses incurred during the said year amounted to Rs. 3,54,86,792/-. In the accounts, the total receipt amounting to Rs. 11,15,01,716/- was adjusted against the amount of Rs. 11,64,66,9771- shown under the head "Loans and Advances in respect of the said two suits and the balance: amount of Rs. 49,65,262/- has been debited to the Profit and Loss Account. In the return of income filed for assessment year 2001-02, the amount of Rs. 49, 65,262/- so debited to the P&L a/c has been added back because in the returns for earlier years filed legal fees paid had been claimed as deduction. Consistent with this method, the net damages of Rs. Rs.7,60,14,924/- received during assessment year 2001-02 (gross damages Rs 11,15,01,716/- after netting off of expenses of Rs.3,54,86,792/- incurred during the said year) have been offered to tax as income in the return of income filed for that AY.

71. Further, it is pointed out that the ITAT has decided the issue in favour of the company in A.Y. 96-97 on the basis that payment of fees had been made against the bills raised by the attorneys. Accordingly the payment was in discharge of accrued liability and not prepaid expenses. **It is pointed out that the Gujarat High Court did not admit the appeal of the revenue against the said order of ITAT.** The same view has been taken by the ITAT in A.Y. 1997-98. It is submitted that the

facts of the case for the year under consideration are identical to those of A.Y. 1996-97 and 1997-98. As such, it is contended that the issue is squarely covered by the aforesaid decisions of ITAT. It is further submitted that during the assessment years 2000- 2001 and 2001 - 2002 disallowance was confirmed by CIT (A) for the reason that in those years it had not been shown that the liability had accrued and crystallized during relevant previous years nor evidence of the same was furnished before the AO despite specific requirement raised by him. Nor was the said evidence furnished in appeal. On these facts, it was held in the said two A.Y.s that deduction cannot be allowed merely because payment has been made as no deduction is allowable for prepaid expenses.

72. Be that as it may, it is asserted that the factual position during the year under consideration is completely different from that in assessment years 2000-01 and 2001-02 as all the necessary evidence of payments alongwith bills of the Foreign Attorneys' and detailed note on allowability of the claim were furnished before the assessing officer vide letter dated 17th March, 2004. However, the assessing officer did not consider these evidences and did not decide the issue on the facts or on the merits of the claim for the A.Y. under consideration. He was merely guided by the disallowance made in A.Y.s 2000-01 and 2001-02 without realizing that the reasons which prompted the disallowance in those years did not exist in the AY under consideration. In this backdrop it is contended that that the AO failed to appreciate that (i) the legal fees paid had been incurred for purposes of the business; (ii) liability for legal fees paid had accrued during the previous year relevant to the AY under consideration as is evident from the attorneys' bills

produced; (iii) the amount of Rs 2.95 crore representing the legal fees had actually been paid during the previous year relevant to assessment year 1999-2000 and that the said expenditure was on revenue account. Thus, it is contended since all the necessary conditions for deduction u/s 37(1) were satisfied the same ought to have been allowed.

73. We have carefully considered the matter. It is seen that the claim of the appellant in A.Y.s 1996-97 and 1997-98 was allowed on the basis that payment of legal fees had been made against the bills raised by the attorneys. As such, the payment was in discharge of accrued liability. However, during the assessment years 2000-2001 and 2001-2002, it had not been shown that the liability for legal fees had accrued and crystallized during the said years. Evidence of the same was not furnished before the AO despite specific requirement by him in this regard. Nor was the said evidence furnished at the appellate stage, In AY 2000-01 the Ld. CIT (A) had confirmed the disallowance for the reason that deduction cannot be allowed merely because payment has been made. No deduction is allowable for prepaid expenses. It has to be shown that payment was made against accrued liability. The position during the year 2001- 2002 remained the same as in the preceding year. Accordingly, for the same reasons as in the preceding year, the disallowance of legal expenses of Rs 1, 47, 04,451/- was confirmed. However, during the A.Y. under consideration the bills of the attorneys along with full supporting evidence of remittance of payment through bank was furnished before the AO. It was explained to the AO that the said expense had been incurred for purposes of the business and the liability had accrued during the

relevant previous year. However, the AO without appreciating the evidence furnished rejected the claim of the assessee on the tenuous plea that the liability will crystallize when the final bills are submitted by the assessee. Further, the assessee has failed to furnish adequate evidence regarding the nature of suits filed, the Structure of fee to be paid to the attorneys, the nature of liability arising in connection with the suits filed etc.

74. During the year under consideration all the essential conditions for deductibility of the legal fees have been established. Respectfully following the decisions of ITAT, Ahmedabad Bench in the case of appellant for A.Y. 1996-97 and 1997-98 **we dismiss the ground of appeal raised by revenue.**

75. **In the result, appeal of the revenue is partly allowed.**

Order pronounced in the open court on 20th day of September, 2023.

Sd/-

(AMIT SHUKLA)
JUDICIAL MEMBER

Sd/-

(GAGAN GOYAL)
ACCOUNTANT MEMBER

Mumbai, दिनांक/Dated: 20/09/2023

Karuna, Sr. PS

Copy of the Order forwarded to:

1. अपीलार्थी/The Appellant ,
2. प्रतिवादी/ The Respondent.
3. आयकर आयुक्त CIT
4. विभागीय प्रतिनिधि, आय.अपी.अधि., मुंबई/DR, ITAT, Mumbai

5. गार्ड फाइल/Guard file.

//True Copy//

BY ORDER,

(Asstt. Registrar)

ITAT, Mumbai