# IN THE INCOME TAX APPELLATE TRIBUNAL
# MUMBAI BENCH "D", MUMBAI

## BEFORE SHRI AMIT SHUKLA (JUDICIAL MEMBER)
## AND
## MS. PADMAVATHY S. (ACCOUNTANT MEMBER)

## I.T.A. No.552 /Mum/2004
## (Assessment year :1998-99)

| | | |
|---|---|---|
| Housing Development Finance Corporation Limited, Ramon House 169, Backbay Reclamation Mumbai-400 020 | vs | The Additional Commissioner of Income-tax, Circle-1(1), Mumbai Aayakr Bhavan, M.K. Road, Mumbai-400 020 |
| **APPELLANT** | | **RESPONDENT** |

| | |
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| Assessee represented by | Shri Nitesh Joshi, Ninad Patade |
| Department represented by | Smt. Riddhi Mishra (CIT DR) |

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|---|---|
| Date of hearing | 15-12-2023 |
| Date of pronouncement | 12-01-2024 |

**O R D E R**

**PER : MS PADMAVATHY S. (AM)**

This appeal is against the order of Commissioner of Income-tax (Appeals)-1, Mumbai dated 31/10/2003 for A.Y. 1998-99.

2. The Assessee is a Housing Finance Institution set up in 1977 with the main object of providing loans for purchase or construction of residential houses in India. It is regulated by National Housing Bank, which is an wholly owned subsidiary of Reserve Bank of India and satisfies all conditions stipulated by the National Housing Bank. The assessee's business activity include, leasing and

providing loans for the purposes other than for purchase or construction of residential house. The assessee, for the purpose of providing housing loan mobilizes bonds from public and also secures loans from various international agencies. The assessee also borrows from National Housing Bank an Life Insurance Corporation of India. The assessee filed the return of income for the assessment year 1998-99 on 30/11/1998 declaring a total income of Rs.146,93,24,570/-. The case was selected for scrutiny and the statutory notices were duly served on the assessee. The Assessing Officer completed the assessment by assessing the income at Rs.232,01,37,101/-. Aggrieved, the assessee filed the appeal before the CIT(A), who partially allowed the appeal. Aggrieved, the assessee is in appeal before the Tribunal.

3. The effective issues arising for our consideration in the present appeal are as under –

*(a) Whether the Appellant would be entitled to deduction in respect of provision for exchange loss on foreign currency borrowings arising on account of revaluation of the said borrowings at the year-end (**refer Ground Nos. 1.1 to 1.3 of the Concise Grounds of Appeal**);*

*(b) Whether in arriving at the quantum of deduction available to the Appellant under section 36(1)(viii) of the Income-tax Act ('the Act') the Appellant is justified in taking into consideration:*

*(i) income by way of interest on loans given for residential purposes for period less than 5 years;*

*(ii) income by way of interest on loans for non-residential purposes; and*

*(iii) income by way of interest / discount etc. from temporary deployment of funds in treasury operations (**refer Ground Nos. 2.1 to 2.3 of the Concise Grounds of Appeal)***

*(c) Whether the deduction allowable for interest paid on foreign currency borrowings and provision for contingencies should also be allocated as deductible against income which is alleged to be ineligible for deduction under section 36(1)(viii) of the Act, and further, whether other common expenses should be allocated in the final ratio of eligible to the ineligible income. (**refer Ground No. 2.4 of the Concise Grounds of Appeal)***

*(d) Whether the Revenue was justified in making a disallowance of interest and other administrative expenses in the present case by invoking the provisions of section 14A of the Act (**refer Ground Nos. 3.1 to 3.3 of the Concise Grounds of Appeal).***

*(e) Whether the CIT(A) was justified in enhancing the disallowance under section 14A of the Act by making such disallowance also in respect of income from tax free bonds (**refer Ground Nos. 4.1 and 4.2 of the Concise Grounds of Appeal).***

4. During the course of hearing the ld AR did not press Ground 1 (Ground 1.1 to Gorund 1.3) relating to provision for forex loss arising out of reinstatement of loan balances and the same is dismissed as not pressed.

**DEDUCTION UNDER SECTION 36(1)(viii) – Ground 2 (Ground 2.1 to 2.4)**

5. During the year under consideration, the assessee has claimed an amount of Rs.101,58,37,175/- as deduction under section 36(1)(viii) of the Act. The assessee has shown the income arising from housing finance business at Rs.247,36,18,306/- and had claimed 40% of the same as deduction under section 36(1)(viii) of the Act. The income from housing finance has been arrived at as under:-

| | | |
|---|---|---|
| 1 | **Interest on loans** | |
| | Other loans | 842,91,65,895 |
| | Interest on loans against Deposit | 2,65,62,315 |
| 2 | **Fee Income:** | |
| | Processing, Administrative Fees & Commitment Charges | 38,22,97,399 |
| | Prepayment Charges | 4,01,28,320 |
| | APF Fees | 1,36,203 |
| | Dishonoured Cheque charges | 3,28,859 |
| | Draft Agreement Charges | 1,300 |

| | | |
|---|---|---|
| 3 | **Interest on Deposits** | |
| | Corporate Deposits | 84,88,53,584 |
| | Rent Deposits | 65,01,534 |
| | COD Banks / Financial Institutions | 4,25,21,587 |
| | IDBI Deposits | 66,839 |
| | Interest on Bank Deposits | 20,61,07,824 |
| 4 | **Interest on investments** | |
| | Debentures | 78,31,16,718 |
| | Government Securities | 17,45,27,134 |
| 5 | **Other Interest Income** | |
| | Investment Application Money | 85,57,474 |
| | Discount on Treasury Bills | 3,28,98,812 |
| | Commercial Paper | 7,71,564 |
| 6 | **LEASE RENTALS** | - |
| 7 | **DIVIDEND INCOME** | - |
| 8 | **PROFIT ON SALE OF INVESTMENTS** | |
| | Profit on redemption of Debentures / Govt. Securities | 1,09,49,675 |
| | Profit on sale of debentures / Govt Securities | 4,46,32,239 |
| 9 | **OTHER INCOME** | |
| | Incidental Charges | 34,76,077 |
| | **GROSS TOTAL INCOME** | **1104,16,01,352** |
| | **OVERALL RATIO of Housing Finance (%)** | **76.43** |
| | **Income from Housing Finance (Excluding Dividend & Capital Gains) (%)** | **81.59** |
| | **Other Income (%)** | **18.41** |
| | **Total – (%)** | **100** |
| | **APPORTIONMENT OF PROIT BEFORE TAX** | |
| | **Gross Income** | **1104,16,01,352** |
| | **Less :** | |
| | Lease Depreciation (Actuals) | - |
| | Other Depreciation (Allocated in the ratio 81.59 : 18.41) | 6,00,64,244 |
| | Other Expenses (Allocated in the ratio 81.59 : 18.41) | 850,79,18,712 |
| | **Total Expenses** | **856,79,82,956** |
| | **Profit Before Tax** | **247,36,18,396** |

6. The assessee, in the notes to the computation of income contented that the profit derived from business of long term finance as referred to above under section 36(1)(viii) would include –

(i) Income from housing loans for residential purposes for a period less than 5 years amounting to Rs.81,37,21,643/-;

(ii) Income from housing finance for non residential units loans – Rs.42,18,07,237/-.

7. The assessee submitted before the Assessing Officer that the deduction under section 36(1)(viii) be recomputed after inclusion of the above stated income. The assessee's plea to include these two amounts were based on the condition that the main purpose / object of the assessee is predominantly providing long term finance for residential purposes and in the course of carrying on such business, the company in certain circumstances would have given loans for a period of less than 5 years and also for non residential housing. The assessee further submitted that it is the income from the business of long term finance that is eligible for deduction under section 36(1)(viii) of the Act and therefore it was submitted that the above two income is also eligible for deduction under section 36(1)(viii) of the Act.

8. The Assessing Officer did not accept the contentions of the assessee for the reason that the definition of the term "long term finance" given in clause (e) of Explanation to section 36(1)(viii) provides that any income derived from providing loans other than from long term finance or loans given other than for residential purposes are debarred from the ambit of eligibility criteria. The Assessing Officer held that such income from loans for less than 5 years of maturity and loans for non residential purposes are clearly beyond the scope of consideration and quantification of deduction under section 36(1)(viii) of the Act.

9. In the course of assessment, the Assessing Officer also noticed that the assessee has included certain other incomes such as income from treasury activities of Rs.210,39,23,070/- and interest on loans against deposits, process fees profit and redemption / sale of debentures, etc. of Rs.40,19,09,989/- as income for the purpose of claiming deduction under section 36(1)(viii) of the Act). The Assessing Officer held that these categories of income would not fulfill the test of minimum

effective source of direct and proximate source and hence, they cannot be said to be derived from the business of providing loan from finance for residential purposes. The Assessing Officer further held that mere commercial connection of such income with the business of providing finance or residential purposes is not sufficient and this would result in defeating the legislative intent and object. The income from treasury operations are arising out of the assessee's regular activities and such income cannot be considered as derived from the business of providing long term finance for residential purposes as the source of such income are different from the activities of providing long term finance for residential purposes.

10. The assessee, while computing the deduction under section 36(1)(viii) had segregated the income and the expenses under 3 categories, i.e. income from housing finance, income from capital gains / dividends and other income. The assessee had segregated certain expenses based on the ratio between the income from housing finance and other income which was worked out at 81.59**:**18.41. The Assessing Officer, during the course of assessment inserted one more vertical of business viz., Income from leasing finance. The Assessing officer based on the revised allocation income between the verticals of business arrived at the revised ratio (excluding capital gain and dividend) at 64.99**:**35.01. The way in which the AO has allocated various expenses is described as under:

- In the computation of income from business eligible for deduction under section 36(1)(viii) of the Act, the AO has reduced the entire interest on foreign currency borrowings and provision for contingencies as expenditure incurred for earning of income from long term housing finance i.e., the eligible business.
- The AO has allocated depreciation on leased assets solely to the income from leasing
- The AO has allocated interest expenditure (other than foreign currency borrowings) to income from housing business and other income in the ratio of 64.99 : 35.01.

- The AO has allocated other expenses to income from housing business and other income in the ratio of 80:20.

11. The Assessing Officer accordingly altered the allocation of expenses made by the assessee to re-compute the income from housing finance business @ Rs.112,71,41,143. The Assessing Officer accordingly disallowed interest under section 36(1)(viii) to the tune of Rs.52,62,28,121 as against the claim of the assessee that it has short claimed the deduction under section 36(1)(viii) in the return of income with notes for Rs. 11,36,88,893. For ease of reference, the deduction claimed by the assessee in the return of income, the revision made by the assessee through notes and the computation done by the Assessing Officer is tabulated below:-

| | Return of income | | | Return of income with Notes | | | Assessment Order | | |
|---|---|---|---|---|---|---|---|---|---|
| | Housing Finance | Other than Housing Finance | Total | Housing Finance | Other than Housing Finance | Total | Housing Finance | Other than Housing Finance | Total |
| Gross Total Income | 11,04,16,01,352 | 3,40,52,40,138 | 14,44,68,41,490 | 11,04,16,01,352 | 3,40,52,40,138 | 14,44,68,41,490 | 11,04,16,01,352 | 3,40,52,40,138 | 14,44,68,41,490 |
| Add: Housing Loans given for less than 5 years | | | | 81,37,21,643 | (81,37,21,643) | | | | |
| Add: Housing Loan given for non residential purpose | | | | 42,18,07,237 | (42,18,07,237) | | | | |
| Revised Gross Total Income as per Notes | | | | 12,27,71,30,232 | 2,16,97,11,258 | 14,44,68,41,490 | | | |
| - Treasury Income | | | | | | | (2,10,39,23,070) | | |
| - Other income (interest on loans against deposit, processing fees, profit on redemption / sale of debentures / G0Sec) | | | | | | | (14,19,09,989) | | |
| Assessed Gross Total Income | | | | | | | 8,79,57,68,293 | 5,65,10,73,197 | 14,44,68,41,490 |
| Less : Expenses | (8,56,79,82,956) | (2,36,52,75,773) | (10,93,32,58,729) | (9,52,67,48,545) | (7,66,86,27,150) | (3,26,46,31,579) | | | 10,93,32,58,729) |
| | | | | | | | | | |
| Profit Before Tax | 2,47,36,18,396 | (2,36,52,75,773) | (10,93,32,58,729) | 2,75,03,81,687 | 76,32,01,074 | 3,51,35,82,761 | 1,12,71,41,143 | 2,38,64,41,618 | 3,51,35,82,761 |
| Profit eligtible for deduction u/s 36(1)(viii) after tax adjustments | 2,53,95,92,893 | | | 2,82,38,15,126 | | | 1,22,40,22,591 | | |
| Deduction u/s 36(1)(viii) | 1,01,58,37,157 | | | 1,12,95,26,050 | | | 48,96,09,036 | | |

Rs. 11,36,88,893 Rs.52,62,28,121

12. Aggrieved, the assessee preferred further appeal before the CIT(A). The CIT(A) affirmed the stand taken by the Assessing Officer by holding that the intent of the legislature is clear when it comes to the definition, the term "long term finance for residential housing" and any other interpretation would defeat the object of promoting residential house. The CIT(A) further relied on the decision of the Supreme Court in the case of Pandian Chemicals Ltd vs CIT 262 ITR 278 (SC) to hold that the word "derived from" has to be given a narrow meaning. The CIT(A) also relied on the findings given in the orders passed for the A.Ys 1996-97 and 1997-98 to uphold the stand taken by the Assessing Officer with regard to the various streams of income which the assessee had claimed to be part of income from long term finance for housing which is eligible for deduction under section 36(1)(viii). The CIT(A) also upheld the basis on which the Assessing Officer had re-distributed the allocation of expenses while computing the income eligible for deduction under section 36(1)( viii) of the Act. Aggrieved, the assessee is in appeal before the Tribunal.

13. With regard to the loans given for a period of less than 5 years and non-residential loans being eligible for deduction u/s.36(1)(viii), the ld AR submitted that

(i) it is an undisputed fact that assessee is a public company formed and registered in India with the main object of carrying on the business of providing long term finance for construction or purchase of houses in India for residential purposes.

(ii) The said business comprises of raising of funds, inviting applications from persons seeking finance, processing the said applications, temporary

deployment of funds pending deployment in the business, disbursal of loans and collecting the principal amount along with interest from the borrowers which is a continuous activity.

(iii) The raising of funds and the infrastructure necessary for the purposes of providing finance and collection of principal and interest is the same for providing such finance for a period more than 5 years, or a period less than 5 years, or for non residential purposes and that these transactions cannot be regarded as a separate business or activity pursued by the Assessee. All the three categories of transactions are part of Assessee's business of providing long term finance for residential purposes which is its predominant business.

(iv) Income from housing loans for residential purposes for period more than 5 years is 86.31% of its gross revenue from interest on loans/operations and the interest on loan granted for a period less than 5 years is 8.33% and for non-residential loans is 4.32% of the gross revenue from interest on loans/operations.

14. The ld AR explained that the residential loans for period less than 5 years are mainly granted to individuals for construction or purchase of house where the borrower is of an advanced age and his age of retirement from employment does not justify a loan for a period beyond five years. It is also submitted that the loans in this category also include bridge loans to builders and developers. The builders and developers who have been provided such loans, then, sell the residential unit in the project as approved by HDFC. If any purchaser of the residential unit in the project intends to take a loan, then, in such a scenario, proportionate part of loan given to the builder or developer is converted into a loan given to the purchaser of the residential unit which would be for a period of more than five years. In this

regard the ld AR drew our attention to the ledger of the flat purchaser/ borrowers on a sample basis to evidence this fact and to explain that there is no flow of funds but entries are passed shifting the loan from the builder/ developer to the flat purchaser. The ld AR also submitted the (i) a copy of the Master Facility Agreement between Builder and Assessee ("Exhibit – 1.1" - Refer Para 13.3 of the Agreement), (ii) copy of the Loan Agreement between Assessee and the Borrower ("Exhibit – 1.2") (iii) copy of the Sale Agreement between Builder and the Borrower ("Exhibit – 1.3") and (iv) copy of ledger showing internal adjustment ("Exhibit – 1.4"). The ld AR also submitted that it would not be commercially feasible for the Assessee to grant loans to the builder or developer for a period more than 5 years. Loans for non-residential purposes are also given to builders and developers engaged in the construction industry where the residential project includes commercial space like convenience shopping etc. The ld AR, therefore, submitted that income from housing finance for residential purposes for period less than 5 years and such income from housing finance for non-residential purposes should also qualify for deduction under section 36(1)(viii) of the Act as the same is part of the business of providing long term finance.

15. With regard to treasury income and other income being eligible for deduction u/s.36(1)(viii), the ld AR submitted that major portion of funds of the Assessee comprises of deposits from the public and it also raises funds from international organisations and financial institutions in India i.e. the Assessee borrows in wholesale and lends in retail. There is always a time gap between the raising of the funds and their utilisation in the activity of lending to the borrowers. Further the entire amount of approved loan is not disbursed immediately and the disbursement is based on progress of the project and demand raised by the builder or developer. In such cases also, there is always a gap between the approved loan

and the disbursed loan. During the year under consideration, the approved loans stood at Rs. 3,251.27 crores while the disbursed loans were only Rs. 2,753.61 crores. It would be practically impossible for the Assessee to raise funds only when the requirement to lend has arisen. Therefore, as stated above, funds that are raised are temporarily deployed in treasury operations during this period, with a view to recoup the interest cost in part. The Assessee also raises funds by way of public deposits as a part of its fund raising activity. As per the Guidelines issued by National Housing Bank, the Assessee is mandatorily required to invest a certain percentage of deposits raised in the approved Government securities [now commonly known as Statutory Liquidity Ratio (SLR)] which yields interest income. Therefore, the interest income in such cases necessarily emanates from the business of long term housing finance. In so far are debentures are concerned, only income from debentures held as current investment is taken as a part of income eligible for deduction under section 36(1)(viii) of the Act.

16. The Ld AR further submitted that if the Revenue's stand is upheld in the present case, then, it would result in deduction being granted under the said section based on classification of each transaction rather than on profits of the eligible business. This would be contrary to the express provisions of the Act which require that such deduction should be allowed based on profits derived from the business of providing long term finance computed under the head "Profits and gains of business or profession". Also, as per the scheme of the Act income under the head "Profits and gains of business" is to be computed for each source of income. In the present case, housing finance for residential purposes for loan period more than 5 years, or less than 5 years or for non-residential purposes or interest income earned on temporary deployment of funds cannot be regarded as separate sources of income justifying separate computations.

17. The ld AR argued that considering the language of section 36(1)(viii) of the Act, a distinction has to be made between the concept of *profits derived from providing long term finance and profits derived from the 'business of' providing long term finance*. It is an undisputed position that the Assessee is carrying on the eligible business, and therefore the test is to be applied is whether the immediate source of the aforesaid three categories of receipts under consideration is the said eligible business or the said receipts could be regarded as a separate business or activity. Accordingly it was submitted that, the said three categories of receipt cannot be regarded as a separate business or activity and have their immediate source in the business of long term finance for construction and purchase of houses in India for residential purposes. In view thereof, the ld AR prayed that deduction under section 36(1)(viii) of the Act may be granted in respect of all the aforesaid three categories of receipts. In this regard reliance is placed on the decision of the Apex Court in the case of **Standard Refinery & Distillery Ltd. vs. CIT (1971) 79 ITR 589 (SC)**.

18. The ld AR further relied on the decision of the Jurisdictional High Court in **CIT vs. Jayanand Khira & Co. (P.) Ltd. 170 ITR 31 (refer pages 15 to 18 of the case law compilation)** where the Hon'ble Court while concerned with the issue of whether an assessee, that was engaged in the manufacture or production of bus bodies could be regarded as engaged in the business of manufacture or production of motor trucks or buses held that

> "*The crucial expression calling for interpretation in this reference is the `the business of construction, manufacture or production of any one or more of the articles or things specified in the Fifth/Sixth Schedule'. This is exactly the expression used in section 33(1)(b)(B) and section 80E as also in section 80B(7) except with the difference that this clause refers to Sixth Schedule in place of Fifth Schedule.* ***It is pertinent to mention that all the three provisions hereinabove are***

> ***the provisions granting relief to the assessees with a view to give incentive to certain types of industries. The Legislature has in its wisdom used the expression 'for the purposes of business of construction, manufacture or production of' (motor buses in this case) which is of wider connotation than the expression for constructing, manufacturing or producing motor buses****..... Having regard to all these aspects we agree with the Tribunal that bus body–builders are as much carrying the business of manufacturing motor buses as chassis manufactures are .....*" (emphasis supplied).

19. Therefore, the ld AR submitted that section 36(1)(viii) which is a beneficial provision also and which too uses the phrase "business of" should similarly receive a wide interpretation and consequently, income from loans for a period less than five years, or for non-residential purposes or from treasury operations should also be regarded as fulfilling the requirements of profits derived from the business of providing long term finance. The ld AR also placed reliance on the following decisions where subsidies, interest income etc., have been considered as "profits derived from business of the undertaking," and submitted that the same analogy should hold good for the impugned incomes in assessee's case –

(i) **CIT vs. Meghalaya Steels Ltd. 383 ITR 217**
(ii) **CIT vs. Jagdishprasad M. Joshi 318 ITR 420**
(iii) **Tema Exchangers Manufacturers Pvt. Ltd. vs. ACIT** being Order dated 18.07.2018 in ITA No. 415 of 2004
(iv) **CIT vs. Shree Balaji Alloys 287 CTR 459**
(v) **Continental Construction Ltd. vs. CIT 195 ITR 81**
(vi) **ACIT vs. Nahavasheva International Container Terminal Pvt. Ltd.** in Order dated 28.09.2018 in ITA No. 2935/Mum/2012

20. The ld AR drew attention to the cases where exemption under section 10(23FB) of the Act has been extended to interest and other income arising from temporary deployment of funds by venture capital funds and venture capital companies. In these cases, pending the investment in venture capital undertakings, the venture capital fund or the venture capital company had invested the funds in

interest earning securities or units of liquid mutual funds. The Revenue had denied the assessee's claim of exemption on the ground that the said investment was not in a venture capital company and was also in violation of the SEBI guidelines. Upholding the assessee's claim for exemption in respect of such receipts, the Tribunal has held that the short-term investment formed a part of the business of investing in venture capital undertakings and did not violate the SEBI guidelines. An illustrative list of these decision are given hereunder:

- India Value Fund v/s. ACIT (2010) 129 TTJ 611 (Mum.) (refer paragraph 26 at page No. – copy annexed as **Exhibit-4** hereto);
- HDFC Property Fund v/s. ITO (ITA No. 7472/Mum/2017) (Mumbai Tribunal) (refer paragraph 12 at page No. 11 – copy annexed as **Exhibit-5** hereto);
- DHFL Venture Capital Fund v/s. ITO (2016) 157 ITD 60 (Mumbai) (refer paragraph 12 at page No. 8 – copy annexed as **Exhibit-6** hereto);
- ITO v/s. Kshitij Venture Capital Fund (2011) 140 TTJ 6 (Mumbai) (refer paragraph 13 and 14 at page No. 13 – copy annexed as **Exhibit-7** hereto); and
- JM Financial India Fund Scheme v/s. ITO (ITA No. 277/Mum/2019) (Mumbai Tribunal) (refer paragraph 13 to 18 at page Nos. 18 to 25 – copy annexed as **Exhibit-8** hereto)

21. The ld AR therefore submits that, the above-referred three categories of receipts should qualify for deduction under section 36(1)(viii) of the Act.

22. With respect to allocation of provision for contingencies and interest on foreign currency borrowings, the ld AR submitted that, if the aforesaid three categories of transactions are held to be eligible for claim of deduction under section 36(1)(viii) of the Act, then, this issue will not arise. However, if any category of such transactions is held to be not eligible for deduction, then consequently, part of the said cost may also be allocated to the so called income which is not eligible for claiming deduction under the said section because funds

raised by way of foreign currency borrowings and the provision for contingencies could be utilised for or relatable to both the eligible and the non-eligible business. Further, other expenses have been allocated by the AO on an adhoc basis in the ratio of 80:20 towards income from housing finance and income other than from housing finance. After re-characterizing the income between eligible business and ineligible business activities, the AO has determined the ratio of such revenue as 64.99 : 35.01. The ld AR in this regard submitted that allocation of such cost should also be made in the ratio as finally determined consequent to findings given by the Tribunal on re-characterisation of income into eligible and ineligible business.

23. The Ld.DR submitted a detailed written submission and the same is taken on record for adjudication. The brief of the key arguments of the ld DR are as given below -

(1) The Finance Act, 1995 has amended Section 36(1)(viii) to limit the deduction to 40% only in respect of income derived from providing long-term finance for the activities specified in section 36(1)(viii). Now, income arising from other business activities or from sources other than business shall not be taken into account for computing deduction under section 36(1)(viii). 'Long term finance' was defined by the Finance Act 1996 and the "5 year" period is fixed by legislature. The deductions claimed by the assessee do not fall within the definition of long term finance for construction or purchase of houses in India for residential purposes.

(2) The word **"such** business**"** is also very important. The scope of application is very limited and narrow. It clearly means that only profits which arise from such long term housing finance will be eligible for deduction and not

any other income. Even in respect of cases relied upon by the assessee on section 80IA/80IB or other sections for interpreting the phrase 'derived from business of industrial undertaking', the words used in those sections are 'any business', while here the words used are 'such business'. The case laws cited by the assessee are therefore, on different footing and not applicable to the assessee.

(3) The assessee has taken a plea of common management, common business organization, common administration, etc. to state that these businesses will also be considered for the purpose of deduction under section 36(1)(viii) where the assessee itself has offered the income under different business divisions and, therefore, this plea of the assessee cannot be entertained.

(4) With regard to the contention that the main object of the assessee's business is to provide long term finance and that the entire profits of the said business should be allowed, is not correct since the Act does not specify any percentage to justify that if the housing loan advance for more than 5 years beyond certain percentage of total loan, then the same should be considered within the definition of long term housing finance. There is no ambiguity in the language of the provision and, therefore, any other interpretation imported artificially, is not correct.

(5) The reason given by the assessee for lending loans for less than 5 years or for non-residential purpose is not relevant since the period and the purpose of loan are what is relevant for deciding the amount eligible for deduction. The loans given for less than 5 years and for non-residential purposes does not fall within the purview of deduction eligible u/s.36(1)(viii).

(6) The assessee's claim of loans to developers for a period less than 5 years, which is later got converted as loans to individuals, who purchased the flats

from the developer for a period of more than 5 years cannot be the reason to claim deduction for the entire loan given to the developers since it is the individual loan transaction that needs to be looked into as to whether it is a long term loan given for more than 5 years or not. Therefore, the deduction claimed by the assessee with respect to loans given to developers for a period of less than 5 years cannot be in its entirety being claimed to be eligible for deduction under section 36(1)(viii).

(7) The assessee's plea that the loans for non residential purposes are integral part of the loans given to developers engaged in the construction of residential projects which include commercial space like convenient shopping, cannot be considered for eligibility of deduction since the statute has clearly stated that the deduction is given for construction or purchase of houses of residential purposes and, therefore, the amount given for non residential purposes cannot be part of deduction claimed under section 36(1)(viii) of the Act.

(8) The assessee claims that the purpose of other investments is to park temporary surplus. However this facts is not clearly coming out if the statement of accounts where are large investments held for more than 2 years. In the garb of temporary deployment, assessee is claiming benefit for a wide variety of other income, which is not allowable

(9) The assessee has claims that income from treasury operations are a stop gap arrangement for deployment of funds before utilizing them in the business of housing finance and to partly recoup the interest cost in this manner. The Revenue strongly places reliance on the decision of the Hon’ble Supreme Court in the case of Liberty India vs CIT 317 ITR 218 (SC) in which it was held that incentive profits are not eligible profits derived from eligible

business under section 80IB and that they belong to category of ancillary profits of such undertakings.

(10) The assessee has argued that the section uses the phrase 'business of' even the other income is eligible for deduction. The assessee in this regard has it relied on the decisions in the cases of CIT vs Jagdishprasad M Joshi and Tema Exchangers Manufacturers Pvt Ltd. vs ACIT (Para 23 of assessee's submission dtd 20.03.2023 - pg 19). In the said decisions, Hon'ble Bombay High Court relied on the decision of Delhi High Court in CIT vs Eltek SGS P Ltd. (300 ITR 06), and held that interest income would qualify for deduction u/s 80IA/80IB being profits and gains derived from any business of an industrial undertaking, differentiating between sec 80HH and 80IB. However it is to be noted that the decision of Delhi High Court in CIT vs Eltek SGS P Ltd. (300 ITR 06) has been reversed by Hon'ble Supreme Court in CA 2817 of 2010 vide order dated 26.03.2010 and therefore the case laws relied on by the assessee are not reliable.

(11) The assessee while relying on the decision of Hon'ble Apex Court in CIT vs Meghalaya Steels Ltd. 383 ITR 217 contented that the temporary deployment funds are for earning interest income to reduce the cost of borrowing and therefore the ratio laid down by the Hon'ble Apex Court in the above case is applicable whereby the interest income should be included for the purpose of deduction u/s.36(1)(viii). Howeven even in Meghalaya Steels (supra), the hon'ble court allowed transport, power and interest subsidy as they have immediate nexus with the said direct expenses. The Hon'ble Apex Court in the case of Saraf Exports vs CIT (2023) 149 taxmann.com 145 clearly interpreted that the subsidies were reimbursement of an element of cost, and the incentives though had the object to reduce the

cost but were not in the nature of reimbursement of cost. Just as the incentives have independent source of income and are far removed from reimbursement of an element of cost, the income from treasury operations as in the case of assessee also have independent source and are not in the nature of reimbursement.

(12) As per assessee's submission, it is mentioned that there is always a time gap between the reasons of the funds and the utilization in the activity of lending to the borrowers which shows that the source of such income (from interest on deposits and investments, profit on sale of investments, etc.) in no way can be said to be the income from long term finance business. The nexus is not direct but at the best, can only be said to be incidental.

(13) The income from treasury operations in assessee's case has immediate source in deposits / debentures etc. where the funds have been deployed, and not from the housing loans for period more than 5 years. Similarly the income earned from housing loan < 5 years and non-residential loans cannot be said to be from housing loans > 5 years. Therefore as per the ratio laid down in the decisions discussed above including the decision of Meghalaya Steels, the assessee's reliance is misplaced and the income other than from housing loan of > 5 years, cannot be said to be derived from the eligible business.

24. The ld DR also relied on plethora of other decisions to reiterate the submissions made above.

25. We heard the parties and perused the material on record. The assessee through a note to the return of income had included the following incomes eligible for deduction u/s.36(1)(viii)

i. income from housing finance for residential purposes for a period of less than 5 years;
ii. income from housing finance for non-residential purposes; and
iii. income from temporary deployment of funds ["treasury operations"]

26. The AO and the CIT(A) has denied the benefit of section 36(1)(viii) to the income from (i) and (ii) above on the ground that these two incomes do not fall within the definition of long term finance as defined in clause (e) of the Explanation to section 36(1)(viii). The income from (iii) is denied the benefit of 36(1)(viii) for the reason that the same is not "derived" from the business of long term finance and that it would not fulfill the test of immediate and effective source of direct and proximate source and hence they cannot be said to be derived from the business of providing long term finance for residential purposes. So for the purpose of adjudication we will consider the income derived from (i) & (ii) above and income from (iii) separately.

**Income from housing finance for residential purposes for a period of less than 5 years**

27. We will first look at the provisions of section as applicable for AY 1998-99 before proceeding further –

> *(viii) in respect of any special reserve created and maintained by a financial corporation which is engaged in providing long-term finance for industrial or agricultural development or development of infrastructure facility in India or by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses*

*in India for residential purposes, an amount not exceeding forty per cent of the profits derived from such business of providing long-term finance (computed under the head "Profits and gains of business or profession" before making any deduction under this clause]) carried to such reserve account:*

***Provided*** *that the corporation or, as the case may be, the company is for the time being approved by the Central Government for the purposes of this clause:*

***Provided further*** *that where the aggregate of the amounts carried to such reserve account from time to time exceeds twice the amount of the paid-up share capital and of the general reserves] of the corporation or, as the case may be, the company, no allowance under this clause shall be made in respect of such excess.*

*Explanation.—In this clause,—*

*( a) "financial corporation" shall include a public company and a Government company;*

*( b) "public company" shall have the meaning assigned to it in section 3 of the Companies Act, 1956 (1 of 1956);*

*( c) "Government company" shall have the meaning assigned to it in section 617 of the Companies Act, 1956 (1 of 1956);]*

*(d) "infrastructure facility" shall have the meaning assigned to it in clause (23G) of section 10;*

*(e) "long-term finance" means any loan or advance where the terms under which moneys are loaned or advanced provide for repayment along with interest thereof during a period of not less than five years;*

28. From the perusal of the above provisions it is clear that –

(a) The deduction is allowable in respect of any Special Reserve that is created and maintained

(b) In the case of a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes

(c) Deduction is allowed for an amount not exceeding <u>*forty per cent of the profits derived from such business of providing long-term finance*</u>

29. The assessee has segregated the total income into income from Housing Finance Business, Income from Capital Gains / Dividends and Other Income. The

assessee has also segregated the investments into those held under Housing Finance Business which are in the nature of short term and those held for long term investment purposes. The income from the investments is also offered based on the said segregation i.e. under the Housing Finance Business or Capital Gains/Dividend. Within the business of Housing Finance, the assessee derives income from loans which do not fall within the definition of "Long Term Finance" i.e. loans with repayment period of less than 5 years and also income from loans extended for non-residential purposes. The contention of the assessee is that the words "business of providing long-term finance" is wide encompassing and therefore would include housing loans for less than 5 years and loans given for non-residential purposes. The argument of the revenue is that the profits are derived from providing other than long term finance are not eligible for deduction under section 36(1)(viii).

30. The basic conditions for availing the deduction under section 36(1)(viii) are that the assessee should be engaged in the business of providing long term finance and the long term finance should be extended for construction or purchase of houses in India for residential purposes. In the given case there is no dispute that the assessee is engaged in the business providing long term finance for construction or purchase of houses for residential purposes. Accordingly the assessee is entitled to claim deduction under section 36(1)(viii). The dispute here is whether the entire income from the business of long term finance should be considered for the purpose of section 36(1)(viii) or only that part of income which is earned from lending long term finance are eligible for deduction under section 36(1)(viii). The language of the legislature while quantifying the amount of deduction is "**** of the profits derived from such business of providing long-

term finance" and whether this would mean the entire profits of the business of providing long-term finance is the issue here.

31. We notice that section 33AB of the Act which allows deduction to assessee carrying on business of growing and manufacturing tea in India uses similar wordings as under

> *( a) a sum equal to the amount or the aggregate of the amounts so deposited ; or*
>
> *( b) a sum equal to twenty per cent of the profits of such business (computed under the head "Profits and gains of business or profession" before making any deduction under this section),*
>
> *whichever is less :*

32. The Hon'ble Calcutta High Court in the context of deduction allowable under the said section in the case of Goodricke Group Ltd. vs CIT ([2011] 11 taxmann.com 130 (Calcutta)) held that the a purposive interpretation of the aforesaid provision should be made instead of literal construction of the same otherwise, the legislative purpose will be frustrated. The Hon'ble High Court concluded by holding that –

> *28. …….. the second point in the negative against the revenue by setting aside the part of the finding of the authorities below on the second question and hold that the assessee is entitled to the benefit of the entire profit arising out of the business of growing and manufacturing the tea and the amount of tea purchased from outside for blending should not be deducted as the said amount is insignificant in comparison to the amount of tea grown and manufactured by the assessee. ……..*

33. The Hon'ble High Court expressed a similar view in the case Singlo (India) Tea Ltd. vs CIT [2016] 68 taxmann.com 187 (Calcutta) where it is held that –

> *14. Hence the expression "profits of such business" in clause (b) as aforesaid relates to the expression "business of growing and manufacturing tea" as appearing in the beginning of subsection (1) of section 33AB of the Act.*

A combined reading of the ratio laid down by the Hon'ble High Court in both the above case leads us to see the merit in the contention of the ld AR that the profits from business of long term finance for construction or purchase of houses for residential purposes is what should be considered for deduction under section 36(1)(viii) and not the profit from lending long term finance. In assessee's case it was submitted that the total interest income earned by the assessee from lending loans with terms less than 5 years is around 8.33% of the total interest income and therefore the same cannot be excluded from the profits of the business of the long term finance for the purpose of deduction under section 36(1)(viii). We in this regard notice that the Hon'ble Calcutta High Court in the case of Goodricke Group Ltd (supra) while holding that the entire profits should be considered for allowing deduction under section 33AB had held so also for the reason that the tea purchased from outside is very insignificant amount of tea as compared what is grown by the assessee in its garden.

34. We notice that in the Memorandum explaining the provisions in the Finance Bill, 1995 and paragraph 26 of Circular No. 717 dated 14.08.1995 (pages 5 to 7 of the case law compilation), it has been clarified that the legislative intent behind the amendments brought in section 36(1)(viii) of the Act were to deny such deduction in respect of income arising from (a) other business activities or (b) from sources other than business. The income, on which deduction is claimed by the assessee, is not from other business activities but from the core business of long term finance and the source of income is the said business. The purpose for which the loans on which the impugned interest is earned are granted for construction or purchase of house and this fact is not disputed by the lower authorities. In view of these discussions in our considered view, the interest income earned from loans extended

for construction or purchase of house for a period of less than 5 years should also be included in the profits for the purpose of deduction under section 36(1)(viii).

**Income from housing finance for non-residential purposes**

35. The assessee has added a sum of Rs. 42,18,07,237 as part of income for the purpose of claiming deduction under section 36(1)(viii) which was denied by the assessing officer for the reason that the interest is earned from loans that are given for non-residential purposes. The contention of the ld AR is that the housing projects which are constructed by corporate or developer may have an element of non-residential amenities and these cannot be isolated from housing projects. Therefore the ld AR argued that the interest income earned should be considered as part of the profits derived from the business of long term finance for construction or purchase of residential housing.

36. The main purpose of allowing deduction under section 36(1)(viii) is to encourage financial corporations/approved public companies to lend for construction or purchase of residential houses. The income derived from the business of providing long-term finance for construction or purchase of houses in India for residential purposes is eligible for deduction under section 36(1)(viii). In the given case the claim of the assessee is towards interest on loans given for non-residential purposes. Therefore the same cannot be said to be from the business activity of long-term finance for construction or purchase of houses. The assessee has made the claim separately through notes to the return of income from which it is clear that the assessee is able to identify the income as from separate business activity. Therefore we are unable to agree with the contention that lending loans for non-residential is an integral part of the loans lent for residential purposes. Accordingly we hold that the interest income earned by the assessee from loans

given for non-residential purposes are not eligible for deduction under section 36(1)(viii). To this extent we uphold the order of the CIT(A).

**Income from temporary deployment of funds**

37. The main contention of the assessee with regard to this income is that there is first degree nexus between the business of the assessee and the source of income. Therefore the income is part of the income "derived from" the business of providing long finance. However the revenue denied the benefit on the ground that the investment activity should be considered separately and accordingly the income arising is not eligible for deduction u/s.36(1)(viii). Before proceeding further we will understand the nature on interest income earned by the assessee which considered as part of business income for the purpose section 36(1)(viii). The assessee being in the business of lending long term finance for residential purpose raises funds from organizations and financial institutions in India and utilizes the same for lending. At any point in time there is always surplus fund mobilized by the assessee for the reason that the disbursement of loan takes place in tranches and also that the assessee cannot raise a loan only when the requirement to lend arises. These surplus funds are parked by the assessee in investments in order to off set the interest income earned against the interest cost incurred. The assessee also raises funds from public deposits and as per the Guidelines issued by National Housing Bank, the Assessee is mandatorily required to invest a certain percentage of deposits raised in the approved Government securities which yields interest income. Therefore it was argued by the ld AR that there is a first degree nexus between the interest income earned and the business of long term finance for residential purposes. The concept of “income derived from” in contrast to other related concept like “income attributable to” has been a subject

matter of discussion in various decision of the Apex Court. Highlights of some of the principles laid down by these judicial pronouncements are –

(i) Receipts which are incidental to the actual conduct of the business of industrial undertaking yet the same may not fall within the expression of 'derived from' - *Cambay Electrical Supply Co. Ltd. 113 ITR 84*

(ii) The nexus between the income and the industrial undertaking was should be direct and not incidental, otherwise it would not fall within the expression 'profits derived from industrial undertaking' - *Sterling Foods 237 ITR 53 (SC) & Pandian Chemicals Ltd. 262 ITR 278(SC)*

*(iii)* When Section 80-IA/80-IB refers to profits derived from eligible business, it is not the ownership of that business which attracts the incentives but what attracts the incentives under Section 80-IA/80-IB is the generation of profits (operational profits). - *Liberty India Ltd. Vs CIT [2009] 183 Taxman 349 (SC)*

*(iv)* The words "derived from" are narrower in connotation as compared to the words "attributable to". - *Liberty India Ltd. Vs CIT [2009] 183 Taxman 349 (SC)*

*(v)* By using the expression "derived from", Parliament intended to cover sources not beyond the first degree from where the profit/income is generated. - *Liberty India Ltd. Vs CIT [2009] 183 Taxman 349 (SC)*

(vi) There should be direct and proximate connection between carrying on business and the income earned - *Vellore Electric Corpn. Ltd. v. CIT [1997] 93 Taxman 401/227 ITR 557 (SC)*

38. The Hon'ble Supreme Court in the case of CIT(A) vs Meghalaya Steels Ltd [2016] 67 taxmann.com 158 (SC) has discussed all these principles while deciding whether the subsidy received by the assessee is eligible for deduction u/s.80IB/80IC. Before proceeding further to consider the merits of assessee's case it is relevant to reproduce the extracts from the decision of this case where it is held that –

"17. An analysis of all the aforesaid decisions cited on behalf of the Revenue becomes necessary at this stage. In the first decision, that is in Cambay Electric Supply Industrial Co. Ltd.'s case (supra) this Court held that since an expression of wider import had been used, namely "attributable to" instead of "derived from", the legislature intended to cover receipts from sources other than the actual conduct of the business of generation and distribution of electricity. In short, a step removed from the business of the industrial undertaking would also be subsumed within the meaning of the expression "attributable to". Since we are directly concerned with the expression "derived from", this judgment is relevant only insofar as it makes a distinction between the expression "derived from", as being something directly from, as opposed to "attributable to", which can be said to include something which is indirect as well.

18. The judgment in Sterling Foods case (supra) lays down a very important test in order to determine whether profits and gains are derived from business or an industrial undertaking. This Court has stated that there should be a direct nexus between such profits and gains and the industrial undertaking or business. Such nexus cannot be only incidental. It therefore found, on the facts before it, that by reason of an export promotion scheme, an assessee was entitled to import entitlements which it could thereafter sell. Obviously, the sale consideration therefrom could not be said to be directly from profits and gains by the industrial undertaking but only attributable to such industrial undertaking inasmuch as such import entitlements did not relate to manufacture or sale of the products of the undertaking, but related only to an event which was post-manufacture namely, export. On an application of the aforesaid test to the facts of the present case, it can be said that as all the four subsidies in the present case are revenue receipts which are reimbursed to the assessee for elements of cost relating to manufacture or sale of their products, there can certainly be said to be a direct nexus between profits and gains of the industrial undertaking or business, and reimbursement of such subsidies. However, Shri Radhakrishnan stressed the fact that the immediate source of the subsidies was the fact that the Government gave them and that, therefore, the immediate source not being from the business of the assessee, the element of directness is missing. We are afraid we cannot agree. What is to be seen for the applicability of Sections 80-IB and 80-IC is whether the profits and gains are derived from the business. So long as profits and gains emanate directly from the business itself, the fact that the immediate source of the subsidies is the Government would make no difference, as it cannot be disputed that the said subsidies are only in order to reimburse, wholly or partially, costs actually incurred by the assessee in the manufacturing and selling of its products. The "profits and gains" spoken of by Sections 80-IB and 80-IC have reference to net profit. And net profit can only be calculated by deducting from the sale price of an article all elements of cost which go into manufacturing or selling it. Thus understood, it is clear that profits and gains

are derived from the business of the assessee, namely profits arrived at after deducting manufacturing cost and selling costs reimbursed to the assessee by the Government concerned.

19. Similarly, the judgment in Pandian Chemicals Ltd.'s case (supra) is also distinguishable, as interest on a deposit made for supply of electricity is not an element of cost at all, and this being so, is therefore a step removed from the business of the industrial undertaking. The derivation of profits on such a deposit made with the Electricity Board could not therefore be said to flow directly from the industrial undertaking itself, unlike the facts of the present case, in which, as has been held above, all the subsidies aforementioned went towards reimbursement of actual costs of manufacture and sale of the products of the business of the assessee.

20. Liberty India's case (supra) being the fourth judgment in this line also does not help Revenue. What this Court was concerned with was an export incentive, which is very far removed from reimbursement of an element of cost. A DEPB drawback scheme is not related to the business of an industrial undertaking for manufacturing or selling its products. DEPB entitlement arises only when the undertaking goes on to export the said product, that is after it manufactures or produces the same. Pithily put, if there is no export, there is no DEPB entitlement, and therefore its relation to manufacture of a product and/or sale within India is not proximate or direct but is one step removed. Also, the object behind DEPB entitlement, as has been held by this Court, is to neutralize the incidence of customs duty payment on the import content of the export product which is provided for by credit to customs duty against the export product. In such a scenario, it cannot be said that such duty exemption scheme is derived from profits and gains made by the industrial undertaking or business itself.

21. The Calcutta High Court in Merinoply & Chemicals Ltd. v. CIT [1994] 209 ITR 508, held that transport subsidies were inseparably connected with the business carried on by the assessee. In that case, the Division Bench held:—

> "We do not find any perversity in the Tribunal's finding that the scheme of transport subsidies is inseparably connected with the business carried on by the assessee. It is a fact that the assessee was a manufacturer of plywood, it is also a fact that the assessee has its unit in a backward area and is entitled to the benefit of the scheme. Further is the fact that transport expenditure is an incidental expenditure of the assessee's business and it is that expenditure which the subsidy recoups and that the purpose of the recoupment is to make up possible profit deficit for operating in a backward area. Therefore, it is beyond all manner of doubt that the subsidies were inseparably connected with the profitable conduct of the business and in arriving at such a decision on the facts the Tribunal committed no error."

22. However, in CIT v. Andaman Timber Industries Ltd., [2000] 242 ITR 204/109 Taxman 135 (Cal.), the same High Court arrived at an opposite conclusion in considering whether a deduction was allowable under Section 80HH of the Act in respect of transport subsidy without noticing the aforesaid earlier judgment of a Division Bench of that very court. A Division Bench of the Calcutta High Court in Cement Mfg Co. Ltd.'s case (supra) by a judgment dated 15.1.2015, distinguished the judgment in Andaman Timber Industries Ltd.'s case (supra) and followed the impugned judgment of the Gauhati High Court in the present case. In a pithy discussion of the law on the subject, the Calcutta High Court held:

'Mr. Bandhyopadhyay, learned Advocate appearing for the appellant, submitted that the impugned judgment is contrary to a judgment of this Court in the case of CIT v. Andaman Timber Industries Ltd. reported in [2000] 242 ITR 204/109 Taxman 135 wherein this Court held that transport subsidy is not an immediate source and does not have direct nexus with the activity of an industrial undertaking. Therefore, the amount representing such subsidy cannot be treated as profit derived from the industrial undertaking. Mr. Bandhypadhyay submitted that it is not a profit derived from the undertaking. The benefit under section 80IC could not therefore have been granted.

He also relied on a judgment of the Supreme Court in the case of Liberty India v. Commissioner of Income Tax, reported in (2009) 317 ITR 218 (SC) wherein it was held that subsidy by way of customs duty draw back could not be treated as a profit derived from the industrial undertaking.

We have not been impressed by the submissions advanced by Mr. Bandhyopadhyay. The judgment of the Apex Court in the case of Liberty India (supra) was in relation to the subsidy arising out of customs draw back and duty Entitlement Pass-book Scheme (DEPB). Both the incentives considered by the Apex Court in the case of Liberty India could be availed after the manufacturing activity was over and exports were made. But, we are concerned in this case with the transport and interest subsidy which has a direct nexus with the manufacturing activity inasmuch as these subsidies go to reduce the cost of production. Therefore, the judgment in the case of Liberty India v. Commissioner of Income Tax has no manner of application. The Supreme Court in the case of Sahney Steel and Press Works Ltd. & Others versus Commissioner of Income Tax, reported in [1997] 228 ITR at page 257 expressed the following views:—

". . . . . Similarly, subsidy on power was confined to 'power consumed for production'. In other words, if power is consumed for any other purpose like setting up the plant and machinery, the incentives will not be given. Refund of sales tax will also be in respect of taxes levied after commencement of production and up to a period of five years from the date of commencement of production. It

is difficult to hold these subsidies as anything but operation subsidies. These subsidies were given to encourage setting up of industries in the State of Andhra Pradesh by making the business of production and sale of goods in the State more profitable.'

23. We are of the view that the judgment in Merinoply & Chemicals Ltd.'s case (supra) and the recent judgment of the Calcutta High Court have correctly appreciated the legal position.

24. We do not find it necessary to refer in detail to any of the other judgments that have been placed before us. The judgment in Jai Bhagwan Oil and Flour Mills' case (supra) is helpful on the nature of a transport subsidy scheme, which is described as under:

"The object of the Transport Subsidy Scheme is not augmentation of revenue, by levy and collection of tax or duty. The object of the Scheme is to improve trade and commerce between the remote parts of the country with other parts, so as to bring about economic development of remote backward regions. This was sought to be achieved by the Scheme, by making it feasible and attractive to industrial entrepreneurs to start and run industries in remote parts, by giving them a level playing field so that they could compete with their counterparts in central (non-remote) areas.

The huge transportation cost for getting the raw materials to the industrial unit and finished goods to the existing market outside the state, was making it unviable for industries in remote parts of the country to compete with industries in central areas. Therefore, industrial units in remote areas were extended the benefit of subsidized transportation. For industrial units in Assam and other north-eastern States, the benefit was given in the form of a subsidy in respect of a percentage of the cost of transportation between a point in central area (Siliguri in West Bengal) and the actual location of the industrial unit in the remote area, so that the industry could become competitive and economically viable." (Paras 14 and 15)

25. The decision in Sahney Steel and Press Works Ltd.'s case (supra) dealt with subsidy received from the State Government in the form of refund of sales tax paid on raw materials, machinery, and finished goods; subsidy on power consumed by the industry; and exemption from water rate. It was held that such subsidies were treated as assistance given for the purpose of carrying on the business of the assessee.

26. We do not find it necessary to further encumber this judgment with the judgments which Shri Ganesh cited on the netting principle. We find it unnecessary to further substantiate the reasoning in our judgment based on the said principle.

27. A Delhi High Court judgment was also cited before us being Dharam Pal Prem Chand Ltd.'s case (supra) from which an SLP preferred in the Supreme Court was dismissed. This judgment also concerned itself with Section 80-IB of the Act, in which it was held that refund of excise duty should not be excluded in arriving at the profit derived from business for the purpose of claiming deduction under Section 80-IB of the Act.

28. ***

29. For the reasons given by us, we are of the view that the Gauhati, Calcutta and Delhi High Courts have correctly construed Sections 80-IB and 80-IC. The Himachal Pradesh High Court, having wrongly interpreted the judgments in Sterling Foods (supra) and Liberty India's cases (supra) to arrive at the opposite conclusion, is held to be wrongly decided for the reasons given by us hereinabove.

30. All the aforesaid appeals are, therefore, dismissed with no order as to costs."

39. From the plain reading of the above judicial pronouncement of Hon'ble Supreme Court, it can be said that so long as profits and gains emanate directly from the business itself and that there should be a direct nexus between such profits and gains and the industrial undertaking or business then the assessee would be eligible to get a deduction u/s.80IA.

40. Now coming to the merits in assessee's case, on perusal of the records we notice that the assessee has segregated the income from investments between the business of housing finance and other income and the basis for the segregation was explained during the course of hearing. The ld AR submitted that on the income from short term investment of surplus funds which are mobilised for housing finance purposes have been taken under the income stream from housing finance. The ld AR further submitted that the income arising out of other regular investment / treasury activity and long term investments have been considered separately as

other income and no deduction u/s.36(1)(viii) is claimed on the same. Accordingly the ld AR countered the submission of the ld DR that the investments are held by the assessee as long term investments and the income there from is claimed as deduction u/s.36(1)(viii). We notice that the AO/CIT(A) have not looked into this contention and segregation done by the assessee and have denied the deduction by stating that the entire interest income should be considered as other income as the immediate and effective source of such income is "investments" and not "business of housing finance" and accordingly the said income is not "derived from" the business of providing long-term finance for construction or purchase of houses in India for residential purposes. In this regard it is relevant to look at the ratio laid down by the Hon'ble Supreme Court in the case of Meghalaya Steels Ltd (supra) while considering the distinction between the expression "derived from" and "attributable to" where it is held that "derived from" as being something directly from, as opposed to "attributable to", which can be said to include something which is indirect as well. Therefore the test for eligibility for deduction is to be the first degree/direct nexus between the income earned and the business of the assessee. The nature of business of the assessee is lending money for construction / purchase of residential houses which is funded by raising loans from institutions and there is bound to be a time gap in terms funds mobilised and utilised. The assessee is using the idle funds of housing finance business in temporary investments and it is established that the source of investment from which the impugned income is derived is from the housing finance business of the assessee. Therefore the deployment of surplus funds by the assessee in short term investments with an intention to reduce the burden of cost of interest paid on loans in our view has a direct nexus with the business of housing finance. Therefore the income which has a direct nexus with the housing finance business of the assessee

is to be considered as "derived from" the business of providing long-term finance for construction or purchase of houses in India for residential purposes and accordingly will be eligible for deduction u/s.36(1)(viii). The nomenclature of income is not so relevant as the nature of income since the same income which is a business income for somebody can be an income from other sources for someone else. A typical example would be the leasing of property which can either be a business income or income from property depending on whether the leasing is the doing of the business or the exploitation of the property by its owner. In the given case, the deployment of funds in short term investment is part and parcel of housing finance business of the assessee since the idle funds are available in the regular course of business of housing finance and as part of the business activity the assessee keeps these funds in short term investments which earn income.

41. The ld DR submitted that the decision of the Hon'ble Delhi High Court is directly on the issue under consideration where it is held that –

> *13. Question No.5 is directed against the finding of the Tribunal that interest earned on short-term deposits made during the interregnum period between disbursement of funds was not profit derived from the business of providing long-term finance. As held by the Tribunal, this is also an investment of the funds of the assessee for making use of the idle funds remaining with it during the interregnum period. The interest cannot be considered as profit derived from the business of providing long-term finance within the meaning of the Section. No question of law arises out of the factual finding of the Tribunal, which is not challenged as perverse. The question cannot be admitted.*

42. The ld AR as a counter submitted that the Hon'ble High Court has not analysed the issue and has not given any detailed finding on the legality of whether the interest earned is "derived from" the business of long term housing finance. On

perusal of the above observations of the Hon'ble High Court, we are inclined to agree with the submission of the ld AR that the court has not given any specific finding with regard to the correctness of the claim of interest on temporary deployment of funds to be part of deduction claimed u/s.36(1)(viii). Therefore we applying the ratio of the Hon'ble Supreme Court in the case of Meghalaya Steels Ltd (supra), we hold that the income earned by the assessee from deployment of surplus funds on a short term basis is to considered as derived from the business of providing long-term finance for construction or purchase of houses in India for residential purposes since there is a direct nexus between the income earned and the business of the assessee. Accordingly the same shall be included for the purpose of claiming deduction u/s.36(1)(viii).

43. The AO is directed to re-compute the income eligible for deduction u/s.36(1)(viii) afresh in accordance with the directions given in this order and allow the deduction accordingly.

**EXEMPTION UNDER SECTION 10(33) – Ground No.3 (3.1 to 3.3)**

44. The assessee had claimed exemption under section 10(33) of Rs.40,89,24,273/- u/s.10(33) against the dividend income earned. The Assessing Officer called on the assessee to show cause as to why expenses to earn the dividend income should not be apportioned and the exemption under section 10(33) be restricted to the net dividend income. The assessee, in reply submitted that the dividend income earning investments are financed from internal accruals and not out of borrowed funds. The assessee further submitted that the loan funds borrowed by the assessee are institutional loans taken for specific purpose of business of housing finance and cannot be utilized for the purpose of any other

investments and, therefore, the assessee submitted that the interest paid by the assessee on the institutional loans cannot be adjusted against the dividend income and that the assessee has not incurred any other expenditure wholly and exclusively for the purpose of earning the dividend income. The Assessing Officer did not accept the submissions of the assessee. The Assessing Officer placed reliance on circular No.780 dated 04/10/2009 which clarifies that exemption under section 10(33) is to be allowed on net basis and not on gross basis. Therefore, the Assessing Officer was of the view that expenses incurred for earning the exempt income is to be reduced from the gross dividend income before arriving at the deduction under section 10(33) of the Act. The Assessing Officer accordingly arrived at the interest and other expenses to be adjusted against the dividend income for the purpose of exemption u/s.10(33) at Rs.53,01,00,000/- and Rs.71,87,574/- respectively. Since the total of these expenses are more than the dividend income earned by the assessee, the Assessing Officer held that no amount should be allowed to be claimed as exempt under section 10(33) of the Act.

45. Aggrieved, the assessee filed appeal before the CIT(A). The assessee submitted before the CIT(A) that the investment in shares which is earning dividend income is a separate, distinct and divisible activity from the business of housing finance and, therefore, the Assessing Officer is not correct in allocating the interest expenses in proportion to the investment made in dividend earning shares. The CIT(A) recomputed the interest amount by attributing weighted cost method as per below working to arrive at the interest amount of Rs.30,81,41,271/- as against the amount of Rs.53,01,00,00/- arrived at by the Assessing Officer.

| | | |
|---|---|---|
| *AY 1998-99* | *As per our contention* | |
| *Dividend* | | |
| *Allocation of Interest Cost* | *Rs in crores* | |
| *Owned funds (Share Capital & Reserves* | *17,772,398.572* | *17.91%* |
| *Borrowed funds – Housing* | *81,333,981,107* | *18.47%* |
| *Borrowed funds – Others (total of Loan Funds)* | *63,150,553.399* | *63.62%* |
| | *99,256,933,078* | *100.00%* |
| ***Investment Cost*** | | |
| *Cost of shares yielding Dividend exempt u/s10(33) (as pr statement given by Treasury)* | *39,61,553,158* | |
| *Total interest Cost (as per Sch 10)* | *9,828,050,523* | |
| *Less : Interest cost towards housing* | *2,107,553,996* | |
| | *7,720,497,557* | |
| *Prop. Cost of invst. made out of borrowed funds* | *2,520,471,533* | |
| ***Prop.interest cost*** | ***308,141,271*** | |

46. With regard to the other expenditure, the CIT(A) confirmed the stand taken by the Assessing Officer. Accordingly, the CIT(A) gave partial relief to the assessee with regard to the exemption under section 10(33) of the Act.

47. The Ld.AR in this regard invited our attention to paragraphs 7.45 and 7.46 at pages 33 and 34 of the assessment order passed by the AO, wherein, while dealing with section 36(1)(viii) of the Act, the AO has held that the entire borrowings of the Assessee have been utilised for the purposes of the business of housing finance and not for investment in shares. He has specifically held that, shares have been acquired by the Assessee from own funds which are interest free. In view thereof, the ld AR submitted that no part of interest paid on borrowings could be disallowed as incurred for earning of dividend income from shares. The ld AR also

submitted that in the allocation of expenses made by the AO for the purposes of section 36(1)(viii) of the Act, no part of interest expenditure has been allocated to income from capital gains/dividend. The ld AR further submitted that the Hon`ble Jurisdictional High Court in **CIT vs. Reliance Utilities and Power Ltd. (2009) 313 ITR 340 (Bombay) (refer pages 68 to 72 of the case law compilation)** and **CIT vs. HDFC Bank Ltd. 366 ITR 505 (refer pages 64 to 67 of the case law compilation)**, have held that if investments have been made out of mixed funds and sufficient interest free funds are available with the assessee, then, the presumption should be that such investments have been made out of interest free funds and not borrowed funds. This view has also been approved by the Hon'ble Apex Court in the case of **South Indian Bank vs. CIT (2021) 438 ITR 1 (SC)**.

48. The Ld.DR, on the other hand, relied on the order of the lower authorities.

49. We heard the parties and perused the materials available on record. We notice that the Assessing Officer while arriving at the proportionate interest to be adjusted against the dividend income has considered the own funds of the assessee to be at Rs.1777.24 crores and the borrowed funds to be at Rs.8148.45 crores. It is also admitted fact that the cost of shares yielding dividend income is lower than that of the own funds of the assessee. Further the Assessing Officer himself while arriving at the profit eligible for deduction u/s.36(1)(viii) had not allocated any interest expense to the vertical "income from capital gains / dividend". Further it is a settled position that when sufficient own funds are available then, the presumption should be that such investments have been made out of the same and not out of borrowed funds. We are therefore of the considered view that no interest cost need to be adjusted against the dividend income for the purpose of exemption

u/s.10(33). With regard to other expenses, we notice that the Assessing Officer has applied an adhoc percentage of 80% to housing finance and balance 20% is allocated among other verticals of business in their income ratio. In this regard we issue a direction to the AO re-allocate administrative expenditure' based on the actual ratio of the investments yielding exempt income to the total average assets for the relevant financial year and consider the same for the purpose of exemption u/s.10(33).

**DISALLOWANCE UNDER SECTION 14A – Ground No.4 (4.1 to 4.2)**

50. The CIT(A), while adjudicating the issue of exemption under section 10(33) has directed the AO to consider the tax exempt interest arising out investments made by the assessee in tax free bonds and to apply the provisions of section 14A accordingly. In this regard the ld AR submitted that though the tax free bonds would result in interest which would be exempted from tax, the capital gains would be chargeable to tax. It is further submitted that since, such investment would also result in taxable income, no disallowance should be made under section 14A of the Act. The ld AR in this regard placed reliance on judgment of the Hon`ble Apex Court in CIT vs. Indian Bank Ltd. (1965) 56 ITR 77 (SC) (refer pages 90 to 93 of the case law compilation), wherein, it has been held that no part of the expenditure could be disallowed when the investment in securities yielded taxable as well as exempt income. The alternate contention of ld AR is that the investment in tax free bonds stood at Rs.179.51 crores as against shareholders' funds at Rs.1777.23 crores and therefore no disallowance of interest expenditure should be made under section 14A of the Act. Reliance in this regard is placed on Tribunal's order in the cases of Prakash K. Shah Shares & Securities Pvt. Ltd. vs. ACIT (refer page Nos. 73 to 78 of the case law compilation) by order dated 30.09.2016 in ITA No.

944/Mum/2015 and Silvassa Estates Pvt. Ltd. vs. ITO (refer page Nos. 79 to 89 of the case law compilation) being Order dated 14.06.2016 in ITA No.7383/Mum/2012 where this principle has been followed.

51. We heard the parties and perused the material on record. It is an admitted position that the assessee is having own funds more than the amount invested in the tax free bonds. Further the impugned investments as per the submissions of the assessee are resulting in both exempt as well as taxable income. We place reliance on the decision of the coordinate bench in the case of Prakash K. Shah Shares & Securities Pvt. Ltd.(supra) to hold that no disallowance is warranted u/s.14A. The disallowance made in this regard is deleted.

52. Ground No.5 and 6 are general not warranting separate adjudication.

53. In result the appeal of the assessee is partly allowed.

**Order pronounced in the open court on 12/01/2024.**

| **Sd/-** | **Sd/-** |
|---|---|
| **(AMIT SHUKLA)** | **(PADMAVATHY S)** |
| **JUDICIAL MEMBER** | **ACCOUNTANT MEMBER** |

Mumbai, Dt : 12th January , 2024

**<u>प्रतिलिपि अग्रेषित</u>Copy of the Order forwarded <u>to</u> :**

1. अपीलार्थी/The Appellant ,
2. प्रतिवादी /The Respondent.
3. आयकर आयुक्त CIT
4. विभागीय प्रतिनिधि ,आय.अपी.अधि ,.मुबंई/DR, ITAT, Mumbai
6. गार्ड फाइल/Guard file.

BY ORDER,

//True Copy//

Asstt. Registrar / Senior Private Secretary
**ITAT, Mumbai**