IN THE INCOME TAX APPELLATE TRIBUNAL "D" BENCH MUMBAI

BEFORE SHRI GIRISH AGRAWAL, ACCOUNTANT MEMBER
AND
SHRI SUNIL KUMAR SINGH, JUDICIAL MEMBER

ITA No.7447/MUM/2004
Assessment Year: 1999-2000
&
ITA Nos.286 & 287/MUM/2005
Assessment Years: 2000-01 & 2001-02

HDFC Bank Ltd. (successor to Housing Development Finance Corporation Ltd.) HDFC Bank House, Senapati Bapat Marg, Delisle Road, S.O Mumbai – 400013 (PAN : AAACH2702H)	Vs.	Deputy Commissioner of Income Tax, Cir. 1(1), Mumbai
(Appellant)		**(Respondent)**

ITA No.7532/MUM/2004
Assessment Year: 1999-2000
&
ITA Nos. 337 & 724/MUM/2005
Assessment Years: 2000-01 & 2001-02

Additional Commissioner of Income Tax, RG. 1(1), Mumbai	Vs.	HDFC Bank Ltd. (successor to Housing Development Finance Corporation Ltd.) HDFC Bank House, Senapati Bapat Marg, Delisle Road, S.O Mumbai – 400013 (PAN : AAACH2702H)
(Appellant)		**(Respondent)**

Present for:

Assessee : Shri Nitesh Joshi, Advocate
Revenue : Smt. Sanyogita Nagpal, CIT, DR

Date of Hearing : 08.05.2024
Date of Pronouncement : 05.07.2024

O R D E R

PER GIRISH AGRAWAL, ACCOUNTANT MEMBER:

All these six appeals by the assessee and Revenue are directed against the separate orders of Ld. CIT(A)-1, Mumbai, vide orders as listed below:

1.1 In ITA Nos.7532 & 7447/MUM/2004, Order No. CIT(A)-I/IT/778/02-03 dated 24.06.2004 (for AY 1999-2000), arising out of assessment orders passed u/s. 143(3) of the Income-tax Act, 1961 (hereinafter referred to as 'the Act') by ACIT, Circle-1(1), Mumbai, dated 22.03.2002.

1.2. In ITA Nos.337 & 286/MUM/2005, Order No.CIT(A)-I/IT/343/02-03 dated 19.08.2004 (for AY 2000-01), arising out of assessment orders passed u/s. 143(3) of the Act by ACIT, Circle-1(1), Mumbai, dated 28.01.2003.

1.3. In ITA Nos.287 & 724 /MUM/2005, Order No. No.CIT(A)-I/IT/319/03-04 dated 13.09.2004 (for AY 2001-02), arising out of assessment orders passed u/s. 143(3) of the Act by ACIT, Circle-1(1), Mumbai, dated 31.12.2003.

2. In all the six appeals, common issues are raised by both assessee and Revenue in their respective appeals. However, there are certain grounds which are specific to the respective appeal. Since common issues are involved, we take up all the six appeals together to pass a consolidated order. To draw the facts, we take up appeal in ITA No.7447/Mum/2004 for Assessment Year 1999-2000 as the lead case. Our observations and findings in this appeal shall apply mutatis mutandis to the other appeals in ITA Nos.286 & 287/Mum/2005 for Assessment Year 2000-01 and 2001-02 in respect of the common issues. Similarly, for the appeals by the Revenue, we take ITA

No.7532/Mum/2004 for Assessment Year 1999-2000 as the lead case. Our observations and findings in the same shall apply mutatis mutandis to ITA Nos. 337 & 724/Mum/2005 for Assessment Year 2000-01 and 2001-02 in respect of the common issues.

3. Facts gathered from the material on record is that assessee is a housing finance institution set up in 1977 with main object of providing loans for purchase for construction for residential houses in India. It is regulated by National Housing Bank, which is a wholly owned subsidiary of Reserve Bank of India and satisfies all conditions stipulated by the National Housing Bank. The assessee's business activity includes, 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 and Life Insurance Corporation of India. Assessee filed its return of income on 31.12.1999, reporting total income at Rs.135,53,03,060/-. Assessment was completed at assessed total income of Rs.239,91,38,121/- after making various additions and disallowances against which after getting partial relief at the first appellate stage, assessee is in appeal before the Tribunal.

4. Grounds of appeal taken by the assessee for Assessment 1999-2000 are as under:

> *"**1. Disallowance of Provision for exchange loss on foreign currency loans - Rs. 54,85,769/-***
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> *1.1 The learned Commissioner of Income-tax (Appeals) 1, Mumbai ('Id. CIT(A)') erred in confirming the disallowance of provision for exchange loss on foreign currency loans on the ground that it was contingent in nature.*
> *1.2 The Id. CIT(A) erred in holding that the same was allowable only on actual repayment of the loans.*
> *1.3 The Id. CIT(A) erred in not appreciating that the provision was on account of fluctuation in the exchange rate on foreign currency loans as per the mercantile system of accounting consistently followed by the appellant*

and in accordance with Accounting Standard 11 issued by the ICAI and was therefore allowable as a deduction.

2. Deduction under section 36(1)(viii) of the Act Rs.99,25,79,867/-

2.1 The Id. CIT(A) erred in upholding the basis of computation of deduction under section 36(1)(viii) of the Income-tax Act, 1961 ('Act') adopted by the assessing officer ('AO') without considering in its correct perspective, the factual and legal contentions raised by the appellant.

2.2 The Id. CIT(A) further erred in excluding the following amounts in computing the profits eligible for deduction under section 36(1) (viii):

(i) Income from housing finance for residential purpose for a period of less than 5 years.
(ii) Income from housing finance for non-residential purpose.
(iii) Income earned on temporary deployment of funds in investments, which are statutorily required to be made in the business of housing finance.

2.3 The Id. CIT(A) erred in not appreciating that having regard to the nature of the business of the appellant, the following amounts are to be considered as an integral part of the main business of housing finance eligible for deduction under section 36(1)(viii) of the Act:

(i) interest on inter-corporate deposits
(ii) interest on deposits and investments
(iii) interest on investment application amounts, discount on Treasury Bills and Commercial paper
(iv) Profit on sale / redemption of debentures / securities
(v) Incidental charges
(vi) Processing administrative fees and commitment charges

2.4 The Id. CIT(A) erred in allocating expenses erroneously, arbitrarily and on incorrect assumptions, for the purpose of computing the profits eligible for deduction under section 36(1)(viii) of the Act.

He erred in not allocating expenses in the proportion of gross receipts from the activity of housing finance and non-housing finance, and instead in allocating expenditure on the following basis:-

(i) interest paid on foreign currency borrowings, allocated wholly to income from long-term finance.
(ii) interest paid on domestic borrowings, allocated in the ratio of gross revenues, without adjusting the allocation made by the AO, referred to in (i) above, and
(iii) other common expenses allocated on an adhoc basis in the ratio of 80:20 without assigning any reasons for the same.

3. Computation of income from dividends exempt under Section 10(33) of the Act

3.1 The Id. CIT (A) erred in confirming allocation of other expenses, as expenditure incurred in relation to earning the dividend income.

4. Computation of income in respect of tax-free bonds and Section 10(23G) bends

4.1 The Id. CIT (A) erred in not granting full exemption in respect of interest of Rs.11,60,23,691/ on tax-free bonds and interest of Rs.32,83,64,856/- on Section 10(23G) bonds, having failed to appreciate that the investments in aforesaid bonds was made out of capital and reserves of the appellant company and therefore no interest on borrowings could be attributed to the tax free interest income earned.

4.2 The Id. CIT(A) erred in not appreciating that the AO has himself observed in the assessment order that the investments in tax free bonds and Section 10(236) bonds have been made out of capital and reserves of the appellant company.

4.3 The Id. CIT (A) failed to appreciate that the AO had worked out the interest cost at 70% of the total interest on such bonds, without any basis, whatsoever and in a totally arbitrary manner.

5. Addition on account of receipt of non-compete fees Rs.5 crores.

5.1 The Id. CIT (A) erred in confirming the addition of Rs.5 crores as non-compete fees, to the income of the appellant having failed to appreciate that the same was neither taxable as revenue receipt nor liable to capital gains tax under section 45 of the Act."

5. From the above grounds, we take note of the effective issues arising for our consideration 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 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 4.3 of the Concise Grounds of Appeal).

f) Whether the ld. CIT(A) was justified in confirming the addition of Rs.5 crores towards receipt of non-compete fees when it was taxable neither as revenue receipt nor liable to capital gains tax (refer ground no.5.1 of the concise grounds of appeals).

6. In the course of hearing before us, ld. Counsel for the assessee did not press ground No.1 (1.1 to 1.3) in respect of provision for exchange laws of foreign currency borrowings arising out of reinstatement of loan balances for all the three appeals filed by it. Accordingly, the same is dismissed as not pressed in all the three appeals.

7. We now take up second effective issue before us in respect of deduction of Rs.99,25,79,867/- claimed by the assessee u/s. 36(1)(viii). During the year, assessee has reported income from housing finance business at Rs.244,46,63,026/-. For the purpose of computing deduction u/s. 36(1)(viii), income from housing business is worked out at Rs.248,14,668/- and it has claimed 40% of the same as deduction u/s.36(1)(viii), i.e., at a figure of Rs.99,25,79,867/-.

1	**Interest on Loans**	
	Housing Loans	10,167,313,229
	Interest on Loans Against Deposits	34,392,439
2	**Fee Income:**	
	Processing, Administrative Fees and commitment Charges	5,21,253,995
	Prepayment Charges	51,953,437
	APF Fees	176,000
	Dishonoured Cheque Charges	484,845
	Draft Agreement Charges	500
3	**Interest on Deposits**	

	Corporate Deposits	1,301,388,075
	COD-Banks/Financial Institutions	2,761,916
	IDBI Deposits	92,632,663
	Interest on Bank Deposits	362,033,725
4	**Interest on Investments**	
	Debentures	774,655,522
	Government Securities	127,946,436
5	**Other Interest Income**	
	Investment Application Money	1,225,179
	Discount of Treasury Bills	3,632,144
6	**Lease Rentals**	--
7	**Dividend Income**	--
8	**Profit on Sale of Investment**	
	Profit on redemption of Debentures/Govt. Securities	6,748,846
	Profit on sale of Debentures/Govt. Securities	1,926,284
9	**Other Income**	
	Incidental Charges	3,587,016
	Gross Total Income	**13,454,112,251**
	Overall Ratio of Housing finance (%)	**76.76**
	Income from Housing Finance (Excluding Dividend & Capital Gains)(%)	**83.30**
	Other Income (%)	**16.70**
	TOTAL – (%)	**100**
	APPORTIONMENT OF PROFIT BEFORE TAX	
	Gross Income	**13,454,112,251**
	Less:	
	Other Depreciation (Allocated in the ratio 81.59 : 18.41)	63,307,993
	Other Expenses (Allocated in the ratio 81.59 : 18.41)	10,946,141,232
	Total Expenses	11,009,449,225
	Profit Before Tax	**2,444663,026**

8. In the course of assessment, ld. Assessing Officer noted that assessee has considered the following income in determining profits derived from the business of providing long time finance for construction or purchase of houses for residential purposes.

a) Interest on deposits	Rs. 176,22,16,379/-
b) Interest on debentures	Rs. 77,46,55,522/-
c) Interest on investment application money	Rs. 12,25,179/-
d) Interest on Govt. securities	Rs. 12,79,46,436/-
e) Discount and Treasury bill	Rs. 36,32,144/-
f) Profit on redemption of debentures/ securities	Rs. 67,48,846/-
g) Profit on sale of debentures	Rs. 19,26,284/-
h) Incidental charges	Rs. 25,87,016/-

8.1. Further, ld. Assessing Officer noted that assessee has shown processing, administrative charges of Rs.52,20,06,563/- as part of income derived from the business of providing long term finance. 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 is 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.

8.2. 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. Assessee had segregated certain expenses based on the ratio between the income from housing finance and other income which was worked out at 83.80 : 16.70. Ld. Assessing Officer, during the course of assessment inserted one more vertical of business viz.,

Income from leasing finance. Ld. Assessing officer based on the revised allocation of income between the verticals of business arrived at the revised ratio (excluding capital gain and dividend) at 66.25 : 33.75. The way in which the AO has allocated various expenses is described as under:

(i) 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.

(ii) AO has allocated depreciation on leased assets solely to the income from leasing

(iii) AO has allocated interest expenditure (other than foreign currency borrowings) to income from housing business and other income in the ratio of 66.25 : 33.75

(iv) AO has allocated other expenses to income from housing business and other income in the ratio of 80:20.

8.3. Ld. Assessing Officer accordingly altered the allocation of expenses made by the assessee to re-compute the income from housing finance business @ Rs.111,94,30,835/-. He thus, disallowed interest under section 36(1)(viii) to the tune of Rs.54,48,07,533/- as against the claim of the assessee.

9. In the course of hearing before us, ld. Counsel for the assessee pointed out that issue relating to quantum of deduction available to the assessee u/s.36(1)(viii) by taking into consideration interest income on loans given for residential purposes for a period of less than five years, interest income on loans for non-residential purposes and interest /discount, etc. income from temporary deployment of funds in treasury operations (ground no.2.1 to 2.4) have already been dealt and decided by the Co-ordinate Bench of ITAT, Mumbai in assessee's own

case for Assessment Year 1998-99 in ITA No.552/Mum/2004 dated 12.01.2024. In this respect, ld. Counsel submitted that issue relating to interest income from housing finance for residential purposes for a period of less than 5 years and interest / discount, etc., income on temporary deployment of funds have been held in favour of the assessee by holding the same to be eligible in computing the profit eligible for deduction u/s. 36(1)(viii). However, issue relating to interest income from housing finance for non-residential purposes is held against the assessee and not eligible for computing the eligible profit for deduction u/s.36(1)(viii).

9.1. Further, ld. Counsel stated that ground No.2.4 is part of issue relating to taking into consideration interest income held on temporary deployment of funds in investments and treasury operations for computing eligible profit for deduction u/s.36(1)(viii). Also, ld. Counsel submitted in respect to allocation of various expenses that interest paid on foreign currency borrowings ought to be allocated between income eligible for claiming deduction u/s.36(1)(viii) and income not so eligible. For other expenses, he submitted that these should be allocated in the ratio as finally determined after giving effect of findings in the present appeal, that is consequent to the findings of the Tribunal on re-characterization of income into eligible and not eligible business. For this also he referred to the findings given by the Co-ordinate Bench in assessee's own case for Assessment Year 1998-99 wherein direction had been given to the ld. Assessing Officer to re-compute the profit eligible for deduction u/s.36(1)(viii).

9.2. From the perusal of the order of the Co-ordinate Bench in assessee's own case (supra), we note that the facts and circumstances are similar in the present case before us and there is no material

change in the applicable of law. The said order has extensively dealt with all the issues before us as stated above and has considered the submissions made by the ld. Counsel of the assessee as well as the ld. CIT, DR. We do not find anything more to add on to the elaborate discussions made therein and the findings so arrived at. The relevant observations and findings are extracts below for ready reference which squarely applies in the present case before us, to deal with the issues raised in ground no.2.1 to 2.4.

> *"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).*
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> *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*
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> > *"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 ....."*
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> > *(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). However, 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 Id 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 Explana-

tion 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 carrving 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 forty per cent of the profits derived from such business of providing long-term finance

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 Id 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 Id 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 Id 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 Id 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 80-1A/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.801B/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 80-1B 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.801A.

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 Id 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 Id 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 Id AR countered the submission of the Id 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 Id 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 Id 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 Id 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.

9.3. Thus, following the above appellate order for AY 1998-99 in assessee's own case, it is held that for Assessment Year 1999-2000, there being no material change in facts and applicable law, the disallowance made by the ld. Assessing Officer is to be allowed after re-computing the income eligible for deduction u/s.36(1)(viii) afresh in accordance with the directions noted in the aforesaid appellate order for Assessment Year 1998-99 and allow the deduction accordingly. Thus, ground no.2 (Ground Nos. 2.1 to 2.3) is partly allowed.

9.4. With respect to the allocation of provisions for contingencies and interest on foreign currency borrowings, we direct the ld. Assessing Officer to apportion part of the cost towards the income which has been held to be not eligible for claiming deduction u/s.36(1)(viii), since interest income from housing finance for non-residential purpose has been held to be not eligible for deduction u/s.36(1)(viii). Also, in respect of other expenses we set aside the allocation done by the ld. Assessing Office on ad-hoc basis in the ratio of 80:20 towards income from housing finance and income other than from housing finance and adopt the recomputed ratio in terms of our directon. Considering our observations and findings, certain income has been re-characterized as income from eligible business and those from ineligible business activities. Accordingly, ld. Assessing Officer is

directed to reallocate such cost in the ratio as finally determined consequent to the findings given herein on re-characterisation of income into eligible and ineligible business. Ground No.2.4 is partly allowed.

10. On the fourth issue relating to disallowance of expenses towards earning of exempt income u/s.10(33) vide ground no.3, it is noted that assessee received gross dividend of Rs.75,23,97,623/- claimed as exempt u/s.10(33). Ld. Assessing Officer asked the assessee as to why expenses to earn dividend income should not be apportioned and the exemption u/s.10(33) be restricted to the net dividend income. In this respect, assessee furnished details of investment yielding exempt income and share holders fund as at 31.03.1999 which is tabulated as under:

Particulars	**Amount (Rs.)**
Investment in tax free bonds yielding income exempt u/s. 10(15)	329,89,15,444
Investment in infrastructure bonds yielding income exempt 10(23G)	90,23,80,137
Investment in shares yielding dividend income exempt u/s. 10(33)	784,47,62,796
Total investments yielding exempt income	**1204,60,58,377**
Share Capital	119,10,99,350
Reserves & Surplus	1852,73,26,086
Total shareholders' funds	**1971,84,25,436**

10.1. It was submitted that the dividend yielding investments are financed from internal accruals and not out of borrowed funds. According to the assessee, investments are out of its share-holder funds and not out of the borrowings.

10.2. Before us, ld. Counsel for the assessee pointed out that this issue has been dealt with by the Co-ordinate Bench in assessee's own case for Assessment Year 1998-99 (supra) whereby disallowance of interest cost was deleted since investments were made out of own funds. For disallowance of other expenses, ld. Assessing Officer was directed to re-allocate administrative expenses based on actual ratio of the investment yielding exempt income to the total average assets for the year under consideration. From perusal of the said appellate order (supra), we note that the issue has been dealt by the Co-ordinate Bench on identical fact pattern, there being no material change in law. The observations and findings arrived at by the Co-ordinate Bench in this issue is extracted as under:

'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	*Rs. In Crores*	
Allocation of Interest Cost	*17,772,398.572*	*17.91%*
Owned funds (Share Capital & Reserves	*81,333,981,107*	*18.47%*
Borrowed funds - Housing	*63,150,553.399*	*63.62%*
Borrowed funds-Others (total of Loan Funds)	*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 Id AR submitted that no part of interest paid on borrowings could be disallowed as incurred for earning of dividend income from shares. The Id 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 Id 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).”

10.3. Following the aforesaid order of the Co-ordinate Bench in assesse’s own case on identical issue, we also hold that no interest cost need to be adjusted against the dividend income for the purpose of exemption u/s.10(33). Also, with regard to allocation of other expenses, we direct the ld. Assessing Officer to reallocate the same based on 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). Accordingly, ground no.3 is partly allowed.

11. On the fifth issue, relating to disallowance u/s.14(A) in respect to income-tax free bonds and section 10(23) bonds, we note that this issue has also been dealt with by the Co-ordinate Bench in assessee’s

own case (supra). The relevant observations and findings arrived at by Co-ordinate Bench in this respect is extracted below:

> *"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."*

11.1. There being no material change in facts and applicable law, we, following the aforesaid decision, delete the disallowance made in this respect. Accordingly, ground no.4 is allowed.

12. Now we take up sixth issue in respect of addition made on account of receipt of non-compete fees of Rs.5 crores treated as revenue receipt by the ld. Assessing Officer. This issue is specific to Assessment Year 1999-2000 in ITA No.7447/Mum/2004. In the course of Assessment, ld. Assessing Officer noted that assessee has received an amount of Rs.5 crores as non-compete fees from General Electric Capital Corporation (GECC) vide non-compete agreement

dated 05.03.1999. Ld. Assessing Officer called for explanation as to why this receipt should not be brought to tax. In this connection, assessee made a detailed submission bringing out the terms and conditions of the said agreement to justify that it is a capital receipt not chargeable to tax. Assessee contended that vide this non-compete agreement, GECC was to restrain assessee from carrying on certain business activity. Under this agreement, assessee was not required to perform any positive activity or render any service. This receipt by the assessee for undertaking the restraining obligations could not be stretched as to pertaining to performance of any other duty. Assessee thus, claimed that it cannot be treated as business income but constituted capital receipt and therefore not chargeable to tax.

12.1. Ld. Assessing Officer after considering the submissions of the assessee, held the receipt as revenue receipt, assessable to tax. Ld. CIT(A) justified the stand taken by the ld. Assessing Officer and sustained the addition so made.

12.2. Ld. Counsel for the assessee took us through the relevant terms and conditions of the non-compete agreement to demonstrate that this agreement restrained the assessee from carrying on the business activity rather than requiring it for performance of any positive activity or rendering any service. In respect of the agreement, it was stated that GE Capital Services India (GECSI) is an affiliate of GECC who had entered into a joint venture agreement with the assessee, dated 23.12.1993 for setting up and establishing a joint venture company as Country-wide Consumer Financial Services Ltd. (CCFSL) to provide consumer finance services in India. In this joint venture company, GECSL holds 55% of the paid-up capital of CCFSL and balance was held by the assessee. Thereafter, assessee and GECSI arrived at an

understanding whereby assessee would sell 20% of the shares in the equity share capital held by it in CCFSL to GECSI. After this transfer, the joint venture agreement dated 23.12.1993 was terminated and a share-holders agreement was executed governing their inter-se relationship. Following the said transfer of shares by the assessee, it had agreed with GECC not to undertake certain activities as set out in the non-compete agreement dated 05.03.1999. These facts are contained in the caption 'Recitals' of the said agreement. From the definitions and the interpretation, the term 'restricted business' has been defined which shall mean business of financing consumer goods and automobiles in India. Such financing shall include but not limited to financing arrangements entailing a provision of funds or credit assistance, financial leases, sub-leases, hire purchase loans or advances.

12.3. Under the heading 'Covenants of HDFC', the restrictions on the assessee contained the following:

> *"4.1 Restrictions*
>
> *In consideration of payment by GE Capital of an amount of Indian Rupees 50,000,000 (Indian Rupees fifty million) to HDFC upon Closing as envisaged under Section 3, HDFC hereby covenants, undertakes and agrees that except with the prior written consent of GE Capital HDFC shall not, for a period of three (3) years from the Closing Date:*
>
> *(a) be involved as a consultant, promoter, significant investor or partner or franchisee or direct sales associate with any Person, for the purposes of undertaking the Restricted Business in India; or*
>
> *(b) be involved in setting up a joint venture or other similar arrangement in India for undertaking the Restricted Business in India with any foreign or domestic Person; or*
>
> *(c) knowingly solicit or entice or endeavour to solicit or entice away from CCFSL of knowingly employ or aid or assist any other Person or Persons in employing or otherwise retaining the services of any employees of CCFSL; or*
>
> *Provided nothing contained in this Section 4.1, shall restrict HDFC or its Promoted or Co- promoted Companies in its/their normal course of business (a) to provide or avail any financial facility including but not limited to term lending,*

inter-corporate deposits, commercial paper, bills discounting, securitization of assets, portfolio buy-outs from or to any Person, and (b) from undertaking Restricted Business in its/their own name or through a joint venture or other similar arrangement with any Promoted or Co-promoted Companies."

12.4. Thus, it was submitted that in the said agreement, there are pre conditions which preceded the payment of non-compete fee to the assessee for which assessee had to sell 20% of its shareholding of CCFSL to GECSI and the earlier agreement dated 23.12.1993 which was executed for setting up of CCFSL was to be terminated. Assessee had to surrender its rights in CCFSL. The non-compete agreement restricted certain rights of the assessee for a period of three years only which are in regard to "only restricted business".

13. On a specific query by the Bench in respect of whether this agreement tentamounts to agreement in restraint of trade, ld. Counsel submitted that Section 27 of the Indian Contract Act, 1872 provides for an exception to deal with cases of transfer of business which does not amounts to agreement in restraint of trade.

13.1. Ld. Counsel also referred to the amendment brought in by the Finance Act, 2002 by insertion of a new sub clause (xii) in section 2(24) of the Act. He also referred to amendment to section 28 by insertion of clause (va) which are prospective and not relevant to the years under consideration. According to him, for the Assessment Year 1999-2000, there was no provision under the Act to tax the aforesaid non-compete fees as revenue receipt.

13.2. For his contentions, he placed reliance on the decision of Hon'ble Supreme Court in the case of Guffic Chem (P) Ltd. vs. CIT [2011] 332 ITR 602 (SC) which dealt with similar issue relating to Assessment Year 1997-98. In this decision in para 7, Hon'ble Court observed that

receipt of non-compete fees under a negative covalent was always treated as capital receipt until AY 2003-04. It is only vide Finance Act, 2002 w.e.f. 01.04.2003 that the said capital receipt is now made taxable, i.e. vide section 28(va). According to the Hon'ble Court, a liability cannot be created retrospectively and the receipt is a capital receipt which has been brought to tax vide specific legislative mandate effective from 01.04.2003. The relevant extract from the said decision is as under:

> *"One more aspect needs to be highlighted. Payment received as non-competition fee under a negative covenant was always treated as a capital receipt till the assessment year 2003-04. It is only vide Finance Act, 2002 with effect from 1-4-2003 that the said capital receipt is now made taxable [See: Section 28(va)]. The Finance Act, 2002 itself indicates that during the relevant assessment year compensation received by the assessee under non-competition agreement was a capital receipt, not taxable under the 1961 Act. It became taxable only with effect from 1-4-2003. It is well- settled that a liability cannot be created retrospectively. In the present case, compensation received under Non-Competition Agreement became taxable as a capital receipt and not as a revenue receipt by specific legislative mandate vide section, 28(va) and that too with effect from 1-4-2003. Hence, the said section 28(va) is amendatory and not clarificatory Lastly, in CIT v. Rai Bahadur Jairam Valji [1959] 35 ITR 148 it was held by this Court that if a contract is entered into in the ordinary course of business, any compensation received for its termination (loss of agency) would be a revenue receipt. In the present case, both CIT(A) as well as the Tribunal, came to the conclusion that the agreement entered into by the assessee with Ranbaxy led to loss of source of business, that payment was received under the negative covenant and therefore the receipt of Rs. 50 lakhs by the assessee from Ranbaxy was in the nature of capital receipt. In fact, in order to put an end to the litigation, Parliament stepped into specifically tax such receipts under non-competition agreement with effect from 1-4-2003.*
>
> *8. For the above reasons, we set aside the impugned judgment of the Karnataka High Court dated 29-10-2009 and restore the order of the Tribunal. Consequently, the civil appeal filed by the assessee is allowed with no order as to the costs."*

13.3. Ld. Counsel, further placed reliance on the decision of Hon'ble Supreme Court in the case of Shivraj Gupta vs. CIT [2020] 425 ITR 420 (SC) wherein also similar issue was dealt with relating to Assessment Year 1995-96. Hon'ble Court followed its earlier decision in the case of Guffic Chem (supra) to hold that prior to 01.04.2003, amount received by the assessee as non-compete fee on executing

deed of negative covenant was not taxable, it was exempt as capital receipt.

14. Per contra, ld. CIT, DR strongly submitted that the receipt in the hands of the assessee is against temporary cessation of business which is in the normal course of business undertaken by the assessee. For the three years for which restriction is executed, there is no corresponding intangible created in the books of GECC. According to the ld. CIT, DR the non-compete fee received by the assessee is for the loss of income and not for the loss of source of income.

14.1. To buttress her contentions, reliance was placed on decision of Hon'ble Supreme Court in the case of Gillanders Arbuthnot & Co. Ltd. vs. CIT [1964] 53 ITR 283 (SC). In this case, assessee company was carrying on business in diverse line as managing agents, shipping agents, purchasing agents, importers and distributors on behalf of foreign principals and secretaries of other sub concerns. The agency agreement was terminated and the assessee was paid an amount which was computed on the basis of the profits of the business. Assessee claimed this receipt on termination of the agency as receipt of a capital nature not liable to tax which was rejected by the Assessing Officer. Hon'ble Court in this respect held that where on a consideration of the circumstances, payment is made to compensate a person for cancellation of a contract which does not affect the trading structure of his business, nor deprive him of what in substance is his source of income, termination of a contract being the normal incident of the business, and such cancellation leaves him free to carry on his trade, the receipt is revenue: whereby the cancellation of an agency, the trading structure of the assessee is impaired, or such cancellation results in loss of what may be regarded as the source of the assessee

income, the payment made to compensate for cancellation of the agency agreement is normally a capital receipt. Hon'ble Court in the set of facts of this case, agreed with the High Court that what was received by the assessee was income and not capital.

14.2. It was also contended by the ld. CIT, DR that assessee was carrying on the business of consumer financing since 1993 through CCFSL hence it is not the case of loss of source of income.

14.3. In the rebuttal, ld. Counsel for the assessee pointed out that the decision of Gillanders Arbuthnot & Co. Ltd. (supra) has been dealt by the Hon'ble Supreme Court in its later decision of Shivraj Gupta (Supra) in para 6 and 7 whereby it has been observed that High Court misinterpreted the judgment in Gillanders Arbuthnot & Co. Ltd. since in the present case, the Revenue has not impugned the genuineness of the transaction.

15.1. Ld. Counsel also submitted in respect of contention of ld. CIT, DR that assessee was carrying on the business of consumer finance since 1993 through CCFSL that only dividend income was earned for the shareholding of the assessee and the compensation received towards non-compete fee is not in lieu of the erstwhile dividend income it had earned.

15.2. He referred to yet another decision of the Hon'ble Supreme Court in the case of CIT vs. Best and Co. (P) (Ltd.) [1966] 60 ITR 11 (SC) to submit that the non-compete fee received by the assessee under a negative covenant is a capital receipt. In this decision also, Hon'ble Court had dealt with its earlier decision in Gillanders

Arbuthnot & Co. Ltd. (supra). The specific observations and findings by the Hon'ble Court are as under:

> *"This court in Gillanders Arbuthnot and Co. Lat's case (Supra) accepted the said principle and held that the compensation paid for agreeing to refrain from currying on competitive business in the commodities in respect of the agency terminated or for loss of goodwill was prima facie of the nature of a capital receipt*
>
> *In the present case, the covenant was an independent obligation undertaken by the assessee not to compete with the new agents in the same field for a specified period. It came into operation only after the agency was terminated. It was wholly unconnected with the assessee's agency termination. We, therefore, hold that that part of the compensation attributable to the restrictive covenant was a capital receipt and hence not assessable to tax."*

16. We have heard the rival contentions and perused the material on record. We have also given our thoughtful consideration to the various judicial precedents referred by both the parties. Admittedly, it is a fact on record that assessee has received the non-compete fee against the restraint imposed on it from carrying on a business activity rather than requiring it perform any positive activity or render any service. Finding gainful understanding and force from the decisions of the Hon'ble Supreme Court relied upon by the ld. Counsel as discussed above, we find that in the present case, the amount received by the assessee as non-compete fee under a negative covalent is a capital receipt. We are in agreement with the ld. Counsel for the submissions made by him before us which are narrated in the above paragraphs. Further, in this respect, we have perused the relevant clause of the non-compete agreement which is extracted above. We also note that it is only w.e.f. 01.04.2003 vide Finance Act, 2002 that the said capital receipt is brought to tax through section 28(va). The said section is held to be prospective since it is mandatory and not clarificatory in nature. We have also taken note of the exception 1 to section 27 of the Indian Contract Act, 1872, in respect of agreement in restraint of trade which otherwise is to be treated as void. In the present case, the

agreement is in respect of transfer of business requiring certain pre-conditions to be fulfilled subject to which a restrain is put on the assessee in the form of negative covenant. The restriction in the agreement is with regard to restricted business which also has been defined in the said agreement. Assessee has received the amount for undertaking the restraining obligation and therefore it cannot be treated as business income in the year under consideration which is much prior to the amendment brought in by the Finance Act, 2002.

16.1. Considering the facts on record, detailed discussion made above, judicial precedents relied upon by the ld. Counsel and those distinguished as submitted by the ld. CIT, DR, we hold that non-compete fee received by the assessee under the negative covenant is in the nature of capital receipt not exigible to tax since it relates to Assessment Year 1999-2000. Accordingly, ground no.5 taken by the assessee is allowed.

17. In the result, appeal of the assessee in ITA No.7447/Mum/2004 for Assessment Year 1999-2000 is partly allowed.

18. In ITA No.286/Mum/2005 for Assessment Year 2000-01 and in ITA No.287/Mum/2005 for Assessment Year 2001-02, the common grounds are disposed off as noted here under:

i) Ground no.2 relating to deduction u/s. 36(1)(viii), the fact pattern and the applicable law are similar to what we have already dealt with in ITA No.7447/Mum/2004 for Assessment Year 1999-2000.

ii) Also ground no.3 & 4, in these two appeals, are similar to the one dealt with in the aforesaid appeal for Assessment Year 1999-2000.

18.1. Accordingly, there being no material change in the fact pattern and applicable law on the issues dealt with in the aforesaid grounds, our observations and findings arrived at on these issues in ITA No.7447/Mum/2004, applies mutatis mutandis to these two appeals also. We direct accordingly.

19. Further to the above, we now deal with ground no.5 taken by the assessee which is specific to Assessment Years 2000-01 in ITA No.286/Mum/2005 and to Assessment Year and 2001-02 in ITA No. 287/Mum/2005 in respect of disallowance made towards discount amount of Rs.1,82,94,011/- and Rs,2,60,79,450/- respectively, amortised in the accounts towards stock options granted to its employees by holding the same as capital in nature.

20. Brief facts relating to this issue drawn from Assessment Year 2000-01 are that assessee granted stock options to its employees during the year. Assessee amortised discount amount of Rs.1,82,94,011/- in its books of accounts which represents the proportionate charge for the year. Assessee claimed this in accordance with the guidelines by the Securities Exchange Board of India (SEBI). The ld. Assessing Officer observed, in this respect that assessee did not revalidate its claim to treat this amortisation as revenue expenditure and thus deduction was rejected. In the first appeal, after considering the submissions made by the assessee, ld. CIT(A) held this claim of expenditure as capital in nature. He observed that price difference for the concession is granted to the employees by the employer to purchase the shares of the employer by the employees which is nothing but the concession relating to the purchase price of the shares. Since the shares are capital asset, therefore any expense incurred to procure capital asset is in the nature of capital

expenditure. He thus, confirmed the stand taken by the ld. Assessing Officer in this respect.

21. Before us, ld. Counsel for the assessee submitted that this issue is no longer *res integra* and has been elaborately dealt with by the Hon'ble High Court of Karnataka in the case of CIT vs. Biocon Ltd. [2021] 40 ITR 151 (Kar) wherein it has held that discount on issue of ESOPs is allowable as a deduction u/s. 37(1) as primary object is not to waste capital but to earn profits by securing consistent services of employees. Ld. Counsel for the assessee in this respect referred to the substantial questions of law before the Hon'ble Court held in favour of the assessee which squarely covers the present case. The same are reproduced as under:

> *"(1) Whether on the facts and in the circumstances of the case and in law the tribunal was right in holding that the discount on issue of ESOP is allowable deduction in computing the income under the head profits and gains of the business?*
>
> *ii) Whether on the facts and in the circumstances of the case and in law the tribunal was (right in holding that difference between market price of the shares at the time of grant of option and offer price amounts to discount and the same has to be treated as remuneration to the employees for their continuity of service?*
>
> *(iii) Whether on the facts and in the circumstance of the case and in law the tribunal committed an error in not in not examining the scheme of ESOP from which it is clear that the employees will not get any right in the shares till completion of the period prescribed and the expenditure claimed is contingent and recorded perverse finding?"*

21.1. Ld. Counsel referred to para 11 of the said decision wherein it is observed by the Hon'ble Court that deduction of discount of ESOPs over the vesting period is in accordance with the accounting in books of accounts, which has been prepared in accordance with SEBI (Employees Stock Option Scheme and Employees Stock Purchase Scheme), Guidelines, 1999. Ld. Counsel also referred to the decision of Hon'ble Special Bench of ITAT in the case of Biocon Ltd. vs. DCIT

[2013] 35 taxmann.com 335 (Bang) (SB) whereby this issue has been elaborately dealt with and held as allowable expenditure in the hands of the assessee. It is this order of the Hon'ble Special Bench of ITAT which has been affirmed by the Hon'ble High Court of Karnataka (supra). He also placed reliance on the decision of Hon'ble High Court of Delhi in the case of PVR Ltd. vs. CIT [2022] 145 taxmann.com 331 (Del) wherein also, it was held that difference between price at which stock options were offered to employees of assessee company under ESOP and ESPS and prevailing market price of stock on date of grant of such options was allowable as revenue expenditure. In this decision, the judgment by Hon'ble High Court of Karnataka was followed.

22. Per contra, ld. CIT, DR placed reliance on the orders of the authorities below.

23. We have heard the rival contentions and given thoughtful consideration to the judicial precedents referred before us. Considering the facts on record and the judicial precedents discussed above, we find that the issue is covered by the aforesaid judicial precedents in the case of Biocon ltd. and PVR ltd. (supra) in favour of the assessee. Respectfully following the same, the ground taken by the assessee in this respect is allowed.

24. In the result both the appeals of the assessee in ITA No.286 & 287/Mum/2005 are partly allowed.

25. Now we take up appeals filed by the Revenue for three Assessment Years before us in ITA No. 7532/Mum/2004, 724/Mum/2005 and 337/Mum/2005.

25.1. Grounds taken by the Revenue in ITA No.7532/Mum/2004 for Assessment Year 1999-2000 are reproduced as under:

"On the facts and in the circumstances of the case and in law, the learned CIT(A) erred in deleting the disallowance made on account of expenditure claimed as entertainment expenses of Rs. 41,03,281/-."

2. "On the facts and in the circumstance of the case and in law, the Ld. CIT(A) erred in deleting the disallowance made on account of expenditure claimed towards maintenance of Guest House amounting to Rs. 33,12,188/-."

3. "On the facts and in the circumstance of the case and in law, the Ld. CIT(A) erred in directing the AO to delete the disallowance of interest of Rs. 67,74,15,880/- relating to dividend income exempt u/s 10(33) of the I.T.Act."

3b) The Ld. CIT(A) further erred in directing the AO to substitute the working of disallowances by reducing the expenses relating to Capital Gains in the ratio of 29.60% out of Rs. 2,24,16,628/- and on the balance amount of expenses to apply the ratio of 54.66% for the purpose of working out the disallowance relating to dividend income exempt u/s 10(33) of the I.T.Act."

25.2. Ground no.3 above is common in all the three appeals of the Revenue except for variation in the quantum of disallowance. Ground no.1 & 2 are specific to Assessment Year 1999-2000.

26. At the outset, it is submitted before us that ground no.1 towards disallowance of entertainment expenses and ground no.2 in respect of guest house expenses have already been dealt by the Co-ordinate Bench of ITAT in assessee's own case in ITA No.477/Mum/2004 for Assessment Year 1998-99, order dated 16.05.2006, whereby the expenditure so claimed has been allowed. The relevant extracts on the above two issues are extracted from the said order for ease of reference which squarely covers the case of the assessee for the years before us.

"2 Brief facts relating to Ground No 1 are that the Assessing Officer disallowed the guest house expenses incurred by the assessee u/s. 37(1) of the Act relying upon the decision of the Bombay High Court in the case of Ocean Carriers Pvt. Ltd. reported in 211 ITR 357 and Raja Bahadur Motilal Poona Mills Ltd., 212 ITR 175, wherein it was held that the guest house expenses is disallowable u/s. 37(4) and as sub-section 4 of section 37 has been omitted, it has to be considered u/s. 37(1) of the Act. Aggrieved, the assessee went in appeal before learned CIT(A) who allowed the same holding that though the Assessing Officer

was right in considering the expenditure under the general provision of section 37(1) of the Act, in the absence of any specific finding by the Assessing Officer that the expenditure was not incurred wholly and exclusively for the purposes of business, disallowance of the same was ad hoc and arbitrary, particularly in the case of reputed financial institution, with a large turnover and high profitability

3. Aggrieved, revenue is in appeal before us. Learned DR of the revenue relied upon the order of Assessing Officer while learned counsel for the assessec relied upon the order of learned CIT(A). As sub-section (4) of section 37 has been omitted w.e.f. 1.4 1998, the guest house expenses have to be considered under the general provision of section 37(1) and it has to be seen whether the said expenses were wholly and exclusively for the purposes of business The assessee is in the business of financing. We observe that the Assessing Officer has not given any reasons for coming to the conclusion that they are not allowable u/s 37(1). No addition could be made without a specific finding as to the reasons for such disallowance. Therefore, we are not inclined to interfere with the order of learned CIT(A). This ground of the appeal is therefore rejected

4 As regard Ground No. 2, Assessing Officer noticed that the assessee had incurred Rs. 36,86,515/ towards entertainment expenditure but did not provide for the disallowance of the same in spite of the omittance of section 37(2) w.e.f 1.4.98 and the allowability or otherwise of the same is governed by the general provisions of section 37(1) of the Act. The Assessing Officer disallowed the same on the ground that they were ostentations in the nature and therefore non-business expenditure. Aggrieved, the assessee filed an appeal before learned CIT(A) who allowed the same on the ground that the Assessing Officer has not given any specific reason for the same

5. Having considered the submissions of learned DR of the revenue, who relied upon the order of Assessing Officer and the learned counsel for the assessee who relied upon the order of learned CIT(A), we find that the Assessing Officer has in fact not considered the nature of the expenses in detail and has not given any specific reason for such disallowance except saying that they were ostentations in nature. As held by us in ground No. 1 above, no addition can be made without a specific finding that the expenses were not wholly and exclusively for the purpose of business. In this view of the matter, the order of the learned CIT(A) is confirmed.

6. Thus, revenue appeal is dismissed."

27. There being no material change in fact pattern and applicable law on the two issues before us, we, by following the decision of the Co-ordinate Bench of ITAT in assessee's own case for Assessment Year 1998-99, dismiss the grounds taken by the Revenue in this respect.

28. Ground no.3 is common for all the three appeals of the Revenue and has already been dealt with by us while adjudicating upon ground no.3 & 4 of the appeals by the assessee, specifically in ITA No.7447/Mum/2004 for Assessment Year 1999-2000. Accordingly, our observations and findings given while adjudicating ground no.3 and 4 in the appeal of the assessee, squarely applies to this ground common to all the three appeals of the Revenue. We direct accordingly.

29. In the result, the three appeals by the Revenue are partly allowed.

Order is pronounced in the open court on 05th July, 2024

Sd/-	Sd/-
(Sunil Kumar Singh)	(Girish Agrawal)
Judicial Member	Accountant Member

Dated: 05th July, 2024

MP, Sr.P.S.

Copy to :

1. The Appellant
2. The Respondent
3. DR, ITAT, Mumbai
4. Guard File
5. CIT

BY ORDER,

(Dy./Asstt.Registrar)
ITAT, Mumbai