http://www.itatonline.org

IN THE HIGH COURT OF DELHI AT NEW DELHI

% Judgment delivered on: 09.10.2015

+ **ITA 83/2003**

THOMSON PRESS (INDIA) LTD. .....Appellant

versus

COMMISSIONER OF INCOME TAX-II ..... Respondent

AND

+ **ITA 124/2003**

THOMSON PRESS (INDIA) LTD. .....Appellant

versus

COMMISSIONER OF INCOME TAX-II ..... Respondent

Advocates who appeared in these cases:

For the Appellant : Mr SalilAggarwal, Mr Ravi Pratap Mall and Mr S. Krishnan.

For the Respondent : Mr Rohit Madan, Senior Standing counsel with Mr Aakash Bajpai, Mr Rahul Chaudhary Senior Standing Counsel with Mr Ruchir Bhatia.

CORAM:
DR. JUSTICE S.MURALIDHAR
MR. JUSTICE VIBHU BAKHRU

JUDGMENT

VIBHU BAKHRU, J

1. The Assessee – by way of these appeals filed under Section 260A of the Income Tax Act, 1961 (hereafter the 'Act') - impugns a common order dated 5th August, 2002 passed by the Income Tax Appellate Tribunal (hereafter the 'Tribunal') in ITA No.2641/Del/96 and ITA No.2642/Del/96 in respect of the

Assessment Years 1991-91 and 1992-93 respectively. Both the said appeals (ITA No.2641/Del/96 and 2642/Del/96) were filed by the Assessee against separate orders passed by the Commissioner of Income Tax (hereafter the 'CIT') under Section 263 of the Act in respect of AY 1991-92 and AY 1992-93.

2. The controversy involved in the present case relates to whether the Assessee could include notional interest as income in computation of profits and gains derived by its undertaking from export of articles or things, for the purposes of claiming deduction under Section 10A of the Act. The Assessee had credited interest on the surplus generated from its undertaking at NEPZ, NOIDA in the books of accounts maintained for that undertaking. Correspondingly, a *contra* entry was passed by the Assessee in the books of accounts maintained in respect of its Head Office. The Assessing Officer (hereafter the 'AO) did not reject the inclusion of such interest as the profits and gains of the undertaking, which were deducted by the Assessee from its total income for computing its taxable income. The CIT considered the assessment orders passed by the AO to be erroneous as prejudicial to the interest of the Revenue. Consequently, the CIT passed orders under Section 263 of the Act, which were upheld by the Tribunal. This led the Assessee to file the present appeals. By an order dated 22nd May, 2003, these appeals were admitted and the following questions of law were framed:-

"Assessment Year 1991-92

1. Whether the Income Tax Appellate Tribunal was correct in law in upholding the orders passed by the Commissioner of Income Tax u/s 263 of the I.T. Act, 1961, holding the assessment order for the assessment year 1991-92 as erroneous in so far as the same was prejudicial to the interests of the Revenue.?

2. Whether the Income Tax Appellate Tribunal was correct in law, in holding that the income of the assessee company had been under-assessed in so far as it related to the amount of interest debited, aggregating to Rs.8,13,651/- for the Assessment Year 1991-92?

3. Whether the Income tax Appellate Tribunal was correct in law in not considering the alternative submissions pertaining to deduction u/s 80HHC of the Act as also 10A of the Act pertaining to the unit at Faridabad and NEPZ, Noida respectively?

Assessment Year 1992-93

1. Whether the Income Tax Appellate Tribunal was correct in law in upholding the orders passed by the Commissioner of Income Tax u/s 263 of the I.T. Act, 1961, holding the assessment order for the assessment year 1992-93 as erroneous in so far as the same was prejudicial to the interests of the Revenue?

2. Whether the Income Tax Appellate Tribunal was correct in law, in holding that the income of the assessee company had been under- assessed in so far as it related to the amount of interest debited, aggregating to Rs.37,61,132/- for the Assessment Year 1992-93?

3. Whether the Income Tax Appellate Tribunal was correct in law in not considering the alternative submissions pertaining to deduction u/s 80HHC of the Act as also 10A of the Act pertaining to the unit at Faridabad and NEPZ, Noida respectively?"

3. The relevant facts, necessary to consider the controversy in these appeals are, briefly, narrated as under:-

3.1 The Assessee is engaged in the business of running printing presses. The Assessee has three independent undertakings, namely, (i) Thomson Press, Faridabad; (ii) Thomson Press EOU, Noida; and (iii) Thomson Press NEPZ, Noida.

4. Admittedly, the Assessee's undertaking at NEPZ Noida (hereafter referred to as the 'eligible undertaking') fulfilled the conditions as specified under section 10A(2) of the Act as it stood at the material time and, consequently, was eligible for exemption under Section 10A of the Act for a block of five years relevant to the AYs 1991-92 to 1994-95. The Assessee filed its return of income for AY 1991-92 on 31st December, 1991 declaring a taxable income of ₹32,86,776/-. This return was subsequently revised and the Assessee declared a total income of ₹1,45,73,443/-. The income derived by the Assessee from the eligible undertaking was excluded in computation of the declared income.

5. The AO passed an assessment order dated 31st March, 1994 for the AY 1991-92 determining the total income of the Assessee as ₹2,11,15,617/-. Whilst the AO rejected certain expenses as deductible, there was no discussion in respect of the interest included as the profits and gains of the eligible

undertaking; the AO did not object to the inclusion of interest in profits from the eligible undertaking, which were exempt under Section 10A of the Act and, consequently, reduced by the Assessee from its total income for computing the income chargeable to tax

6. The CIT found that the eligible undertaking had accumulated profits of ₹98,05,560/- as on 31st March, 1991 and an interest of ₹8,13,651/- had been charged on the aforesaid surplus in the books of the eligible undertaking. Correspondingly, the Head Office had expensed the aforesaid amount as interest and credited the account of the eligible undertaking in its books of accounts maintained separately. In other words, the separate books maintained in respect of the eligible undertaking reflected interest income of ₹8,13,651/- and the same was also deducted from the taxable income of the Assessee as being income derived by the Assessee from the eligible undertaking.

7. The CIT was of the view that the aforesaid deduction was erroneous as prejudicial to the interest of the revenue and, therefore, issued a show cause notice dated 5th February, 1996 under Section 263 of the Act in respect of the AY 1991-92. A similar notice dated 5th February, 1996 was also issued in respect of the AY 1992-93, as in the Previous Year relevant to AY 1992-93, the Assessee had deducted a sum of ₹37,61,132 on account of notional interest credited in the books of the eligible undertaking.

8. The Assessee responded to the show cause notices by its letter dated 28th February, 1996.

9. The CIT passed an order dated 27th March, 1996 in respect of the AY 1991-92 enhancing the total income of the Assessee by a sum of ₹8,12,651/- by reducing the amount deductible under Section 10A of the Act by the aforesaid sum. The CIT referred to the decision of the Madhya Pradesh High Court in ***Malwa Mills Karamchari Parasper Sekhkari Sanstha Ltd. V. CIT*: (1983) 140 ITR 379 (MP)** in support of his view that the transaction of crediting interest by the Head office to the account of the eligible undertaking was between the two branches of the Assessee and did not give rise to any real expenditure or income. He, accordingly, held that the expenditure could not be allowed in the hands of one unit and correspondingly, the question of enhancing income of the eligible unit by such notional income, did not arise.

10. The CIT also considered alternative pleas on behalf of the Assessee including the plea that relief under Section 80HHC of the Act as available to the Assessee should be computed by including the turnover of the eligible undertaking for the purposes of computing the profits and gains from the exports exempt under Section 80HHC. The CIT held that the aforesaid issue did not arise in the proceedings under Section 263 of the Act and the only issue was with regard to the interest charged in the books maintained by the assessee. Nonetheless, the CIT also considered the question whether the turnover of the

eligible undertaking could be included for the purposes of calculating the exemption available to the Assessee under Section 80HHC.

11. The CIT passed a separate order dated 27th March, 1996 in respect of AY 1992-93 and following its decision for the earlier AY, enhanced the total income of the Assessee by a sum of ₹37,61,132/-. The said enhancement resulted in the income of the Assessee being assessed at ₹4,07,172/- instead of a loss of ₹33,53,960/- as assessed by the AO in its assessment order dated 20th March, 1995. Since the assessed income was now a positive figure, the CIT further directed the AO to compute the relief under Section 80HHC of the Act after giving due opportunity to the Assessee.

12. The Assessee filed appeals against the orders passed by the CIT, *inter alia,* on the ground that CIT had erred in holding that the assessment orders were erroneous as prejudicial to the interests of the revenue. In the alternative, the Assessee contended that the CIT had erred in not allowing deduction under Section 80HHC of the Act by including turnover of the eligible undertaking in the total turnover of the Assessee.

13. The Tribunal rejected the appeals filed by the Assessee. Being aggrieved by the said decision, the Assessee has filed the present appeals.

Submissions

14. Mr Salil Aggarwal, learned counsel appearing for the Assessee contended that the orders passed by the CIT were beyond the scope of Section 263 of the Act. He referred to the decision of the Supreme Court in ***Malabar Industrial Company Ltd. V. CIT*****: (2000) 243 ITR 83 (SC)** and submitted that before proceeding under Section 263 of the Act, the CIT had to be satisfied in respect of two conditions, namely, i) that the order of the AO sought to be revised was erroneous; and ii) that it was prejudicial to the interest of the revenue. He submitted that in a case where two views were possible and the AO had taken one view, it was not open for the CIT to treat the order to be erroneous as prejudicial to the interest of the revenue only for the reason that he did not agree with the AO's view. He submitted that unless the view taken by the AO was unsustainable and patently erroneous, the CIT could not assume jurisdiction under Section 263 of the Act.

15. Mr Aggarwal further argued that in the preceding year 1990-91, the eligible undertaking had debited interest amounting to ₹7,75,399/-, which had been accepted in an assessment framed under Section 143(3) of the Act. He referred to the decision of this Court in the case of ***CIT v. Escorts Ltd.*****: (2011) 338 ITR 435 (Del)** in support of his contention that where a view has been accepted in the preceding assessment years, CIT would have no occasion to take recourse to the revisional powers under Section 263 of the Act.

16. On merits, Mr Aggarwal contended that the decision in the case of ***Malwa Mills Karamchari Parasper Sekhkari Sanstha Ltd.*** (*supra*) was not applicable in the facts of the present case. He sought to distinguish the said decision on the ground that the same was rendered in the context of Section 80P of the Act, which is amongst a funiculus of sections under Chapter VI-A of the Act that provide for *"deductions to be made in computing total income*" of an Assessee; whilst, the present case concerned Section 10A of the Act, which was part of Chapter III of the Act that pertained to "*income which do not form part of the total income*". He argued that the deduction under Section 10A of the Act provided for a deduction in respect of incomes profit and gains derived by an Assessee from an industrial undertaking at the threshold and not as a deduction included in the gross income of an Assessee. He referred to the decision of this court in ***CIT v. TEI Technonlogies (P) Ltd.*****: (2014) 361 ITR 36 (Del)**, in support of the above contention.

17. He submitted that under the scheme of the Act, the eligible undertaking was to be treated as a separate source and its income was not to be intermingled with any other source. He emphatically urged that Section 10A undertaking had to be considered as a separate person whose income was not included in the income of the Assessee. He submitted that in view of the said scheme the reasoning of the CIT and the Tribunal that no one could earn interest from

oneself was not tenable as the eligible undertaking had for all practical purposes to be treated as a separate entity.

18. Mr Aggarwal, further referred to Section 10A(6) of the Act by virtue of which, the provisions of Section 80IA(8) of the Act, insofar as applicable, were incorporated under Section 10A of the Act. Section 80IA(8) provided for the transfer of goods and services held by eligible undertaking to non eligible business to be computed at market value. According to Mr Aggarwal, this indicated that the eligible business and non eligible business were to be treated as separate sources and transactions *inter se* different units of an assessee were recognised for the purposes of calculating the income derived by an Assessee from an eligible undertaking.

19. Mr Aggarwal contended that Section 10A provides for exemption of "income derived by an Assessee from its undertaking". He submitted that this was different from the language used in Section 80HH or 80IA which referred to income "derived from an industrial undertaking". He submitted that this also indicated that an eligible undertaking under Section 10A was to be considered as a separate and independent source.

20. Countering the aforesaid arguments, Mr Chaudhary, learned counsel for the Revenue submitted that irrespective of the merits of the contentions advanced on behalf of the Assessee, interest income could not be considered as

income derived by the Assessee from the eligible undertaking as there was no nexus between the interest claimed to be earned and activities of the eligible undertaking. He referred to the decision of the Supreme Court in ***India Comnet International v. Income Tax Officer*****: (2013) 354 ITR 673 (SC)** in support of this contention that unless a close nexus with the income by way of interest of the undertaking was established, the same could not be considered as a part of profit and gains derived by the Assessee from the eligible undertaking.

21. Mr Aggarwal in his rejoinder submitted that in the present case no other view was plausible and the assessment order was, clearly, erroneous. He submitted that Section 10A did not contemplate any notional income but only such profits and gains that were derived by an Assessee from an undertaking, to which Section 10A applies.

Reasoning and Conclusion

22. The principal issue to be addressed is whether the CIT can assume jurisdiction under Section 263 of the Act and enhance the assessed income by reducing the deduction allowed to the Assessee in respect of the eligible undertaking. According to the Assessee, the interest credited in the books of the Assessee maintained with respect to the eligible undertaking would be part of the profit and gains derived from the eligible undertaking and, thus, deductable from the total income of the Assessee under Section 10A of the Act. It has been

argued that this is a plausible view and, therefore, the assessment order allowing such reduction could not be considered as erroneous.

24. Section 263(1) of the Act empowers the Commissioner to call for and examine the record of any proceeding under the Act and if it is considered that any order passed by the AO is *"erroneous in so far as it is prejudicial to the interest of the revenue"*, he may after giving the Assessee an opportunity to be heard and after making such inquiries as necessary, pass such orders thereon as the circumstances of the case would justify including an order enhancing or modifying the assessment. Thus, in order to exercise powers under Section 263(1) of the Act, the CIT must be satisfied that the assessment order made by the AO was (a) erroneous; and (b) prejudicial to the interest of the revenue. The Supreme Court in the case of ***Malabar Industrial Co. Ltd. vs. CIT***: **(2000) 243 ITR 83 (SC)** had interpreted the provisions of Section 263(1) in the following words:

> "A bare reading of this provision makes it clear that the prerequisite to the exercise of jurisdiction by the Commissioner suo motu under it, is that the order of the Income-tax Officer is erroneous in so far as it is prejudicial to the interests of the Revenue. The Commissioner has to be satisfied of twin conditions, namely, (i) the order of the Assessing Officer sought to be revised is erroneous; and (ii) it is prejudicial to the interests of the Revenue. If one of them is absent-if the order of the Income-tax Officer is erroneous but is not prejudicial to the Revenue or if it is not erroneous but is prejudicial to the Revenue-recourse cannot be had to section 263(1) of the Act.

> There can be no doubt that the provision cannot be invoked to correct each and every type of mistake or error committed by the Assessing Officer, it is only when an order is erroneous that the section will be attracted. An incorrect assumption of facts or an incorrect application of law will satisfy the requirement of the order being erroneous. In the same category fall orders passed without applying the principles of natural justice or without application of mind.
>
> The phrase "prejudicial to the interests of the Revenue" has to be read in conjunction with an erroneous order passed by the Assessing Officer. Every loss of revenue as a consequence of an order of the Assessing Officer cannot be treated as prejudicial to the interests of the Revenue. For example, when an Income-tax Officer adopted one of the courses permissible in law and it has resulted in loss of Revenue ; or where two views are possible and the Income-tax Officer has taken one view with which the Commissioner does not agree, it cannot be treated as an erroneous order prejudicial to the interests of the Revenue, unless the view taken by the Income-tax Officer is unsustainable in law."

25. Following the aforesaid judgment, the Supreme Court in ***Commissioner of Income Tax v. Max India Ltd.*****: (2007) 295 ITR 282 (SC)** reiterated that the phrase "prejudicial to the interest of revenue" as used in Section 263(1) of the Act must be read in conjunction with the expression "erroneous" and unless the view taken by the AO is found to be unsustainable in law, the powers under Section 263 of the Act cannot be invoked.

26. Following the aforesaid decision, this Court in ***Commissioner of Income Tax v. DLF Ltd.*****:(2013) 350 ITR 555 (Del)** had also emphasized that powers

under Section 263(1) of the Act were available only if the order sought to be reviewed was prejudicial to the interests of the revenue and was unsustainable in law.

27. In view of the settled law as indicated above, the issue to be considered is whether the claim of the Assessee for including notional interest as profit and gains derived from the eligible undertaking for the purposes of Section 10A of the Act is sustainable in law.

28. At this stage, it would be necessary to refer to Section 10A of the Act. Section 10A as it stood during the relevant assessment years, is reproduced below:-

> "**10A.** (1) Subject to the provisions of this section, any profits and gains derived by an assessee from an industrial undertaking to which this section applies shall not be included in the total income of the assessee.
>
> (2) This section applies to any industrial undertaking which fulfils all the following conditions, namely:—
>
> (*i*) it has begun or begins to manufacture or produce articles or things during the previous year relevant to the assessment year commencing on or after the 1st day of April, 1981, in any free trade zone;
>
> (*ii*) it is not formed by the splitting up, or the reconstruction, of a business already in existence:
>
> **Provided** that this condition shall not apply in respect of any industrial undertaking which is formed as a result of the reestablishment, reconstruction or revival by the assessee of the business of any such industrial undertaking as is referred to in

section 33B, in the circumstances and within the period specified in that section;

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

Explanation : The provisions of *Explanation 1* and *Explanation 2* to sub-section (2) of section 80-I shall apply for the purposes of clause (*iii*) of this sub-section as they apply for the pur-poses of clause (*ii*) of that sub-section.

[(3) The profits and gains referred to in sub-section (1) shall not be included in the total income of the assessee in respect of any five consecutive assessment years, falling within a period of eight years beginning with the assessment year relevant to the previous year in which the industrial undertaking begins to manufacture or produce articles or things, specified by the assessee at his option :

Provided that nothing in this sub-section shall be construed to extend the aforesaid five assessment years to cover any period after the expiry of the said period of eight years.]

(4) Notwithstanding anything contained in any other provision of this Act, in computing the total income of the assessee of the previous year relevant to the assessment year immediately succeeding the last of the relevant assessment years, or of any previous year, relevant to any subsequent assessment year,—

(*i*) section 32, section 32A, section 33, section 35 and clause (*ix*) of sub-section (1) of section 36 shall apply as if every allowance or deduction referred to therein and relating to or allowable for any of the relevant assessment years, in relation to any building, machinery, plant or furniture used for the purposes of the business of the industrial undertaking in the previous year relevant to such assessment year or any expenditure incurred for the purposes of such business in such previous year had been given full effect to for that assessment year itself and accordingly sub-section (2) of section 32, clause (*ii*) of sub-section (3) of section 32A, clause (*ii*) of sub-section (2) of section 33, sub-section (4) of section 35 or the second proviso to clause (*ix*) of sub-section (1) of section 36, as the case may be, shall not apply in relation to any such allowance or deduc-tion;

(*ii*) no loss referred to in sub-section (1) of section 72 or sub-section (1) [or sub-section (3)] of section 74 and no deficiency referred to in sub-section (3) of section 80J, in so far as such loss or deficiency

relates to the business of the industrial undertaking shall be carried forward or set off where such loss, or, as the case may be, deficiency relates to any of the relevant assessment years;

(*iii*) no deduction shall be allowed under section 80HH or section 80HHA or section 80-I or section 80J in relation to the profits and gains of the industrial undertaking; and

(*iv*) in computing the depreciation allowance under section 32, the written down value of any asset used for the purposes of the business of the industrial undertaking shall be computed as if the assessee had claimed and been actually allowed the deduction in respect of depreciation for each of the relevant assessment years.

(5) Where an industrial undertaking in any free trade zone has begun to manufacture or produce articles or things in any previous year relevant to the assessment year commencing on or after the 1st day of April, 1977, but before the 1st day of April, 1981, the assessee may, at his option, before the expiry of the time allowed under sub-section (1) or sub-section (2) of section 139, whether fixed originally or on extension, for furnishing the return of income for the assessment year commencing on the 1st day of April, 1981, furnish to the [Assessing Officer] a declaration in writing that the provisions of sub-section (1) may be made applicable to him for each of the relevant assessment years as reduced by the number of assessment years which expired before the 1st day of April, 1981, and if he does so, then, the provisions of sub-section (1) shall apply to him for each of such relevant assessment years and the provisions of sub-section (4) shall also apply in computing the total income of the assessee for the assessment year immediately succeeding the last of the relevant assessment years and any subsequent assessment year.

(6) The provisions of sub-section (8) and sub-section (9) of section 80-I shall, so far as may be, apply in relation to the industrial undertaking referred to in this section as they apply for the purposes of the industrial undertaking referred to in section 80-I.

(7) Notwithstanding anything contained in the foregoing provisions of this section, where the assessee, [before the due date for furnishing the return of income under sub-section (1) of section 139] , furnishes to the [Assessing] Officer a declaration in writing that the provisions of this section may not be made applicable to him, the provisions of this section shall not apply to him for any of the relevant assessment years.

[(8) References in sub-section (5) to any other provision of this Act which has been amended or omitted by the Direct Tax Laws (Amendment) Act, 1987 shall, notwithstanding such amendment or omission, be construed, for the purposes of that sub-section, as if such amendment or omission had not been made.]

Explanation : For the purposes of this section,—

(*i*) "free trade zone" means the Kandla Free Trade Zone and the Santacruz Electronics Export Processing Zone and includes any other free trade zone which the Central Government may, by notifica-tion in the Official Gazette, specify for the purposes of this section;

[(*ii*) "relevant assessment years" means the five consec-utive assessment years specified by the assessee at his option under sub-section (3);]]

[(*iii*) "manufacture" includes any—

(*a*) process, or

(*b*) assembling, or

(*c*) recording of programmes on any disc, tape, perforated, media or other information storage device.]]"

29. A plain reading of Section 10A(1) of the Act indicates that profits and gains derived by an Assessee from an industrial undertaking to which Section 10A applies is not included in the total income of the Assessee. Section 10A(2) of the Act specifies the conditions which are to be fulfilled by an undertaking for being eligible for the benefits of Section 10A(1) of the Act. In the present case, it is not disputed that the Assessee's undertaking at NEPZ, NOIDA (i.e. the eligible undertaking) fulfilled the requisite conditions and the profits and gains derived by the Assessee from the eligible undertaking was not to be included in the total income of the Assessee.

30. The expression "derived" followed by the word "from" refers to the source of profits and gains. The Oxford Dictionary defines the word "derived" as "obtained something from (a specified source)" and "arise from or originate in (a specified source)". It is at once clear that in order for any profits and gains to be exempt under Section 10A of the Act, their source must be traced to "the industrial undertaking" to which Section 10A applies. In ***National Organic Chemical Industries Ltd. v. Collector of Central Excise (Bom)***: **106 STC 467 (SC)** the Supreme Court referred to the dictionary meaning of the word "derive" which is usually followed by the word "from" and interpreted the expression "derived from" in the following manner:-

> "**10.** The dictionaries state that the word 'derive' is usually followed by the word 'from', and it means : get or trace from a source ; arise from, originate in ; show the origin or formation of.
>
> **11**. The use of the words "derived from" in Item 11AA(2) suggests that the original source of the product has to be found. Thus, as a matter of plain English, when it is said that one word is derived from another, often in another language, what is meant is that the source of that word is another word, often in another language. As an illustration, the word "democracy" is derived from the Greek word "demos", the people, and most dictionaries will so state. That is the ordinary meaning of the words "'derived from" and there is no reason to depart from that ordinary meaning here."

31. The Supreme Court in ***CIT vs. Sterling Foods*****: (1999) 237 ITR 57 (SC)** considered the question, *"whether income derived by an Assessee from the sale of import entitlements was profits and gains derived from an industrial undertaking"*, in the context of Section 80HH of the Act and held as under:

> "We do not think that the source of the import entitlements can be said to be the industrial undertaking of the assessee. The source of the import entitlements can, in the circumstances, only be said to be the Export Promotion Scheme of the Central Government whereunder the export entitlements become available. There must be, for the application of the words "derived from", a direct nexus between the profits and gains and the industrial undertaking. In the instant case, the nexus is not direct but only incidental. The industrial undertaking exports processed sea food. By reason of such export, the Export Promotion Scheme applies. Thereunder, the assessee is entitled to import entitlements, which it can sell. The sale consideration therefrom cannot, in our view, be held to constitute a profit and gain derived from the assessee's industrial undertaking"

32. Although, the said decision was rendered in the context of Section 80HH of the Act, the same would be equally applicable to the facts of the present case as the court had answered the question involved by interpreting the plain meaning of the expression "derived from", which is also the expression used in Section 10A of the Act (as it stood at the material time). The Supreme Court had explained that the words "derived from" indicate a direct nexus between the profits and gains and its source. The court held that the source of profits from the sale of import entitlements could not be said to be the industrial undertaking as the nexus between the profits and gains from sale of import entitlements and the undertaking was only incidental and not direct.

33. It follows from the above and a plain reading of Section 10A(1) of the Act that only those profits and gains of an Assessee which have a direct nexus with an undertaking to which Section 10A of the Act applies would be excluded from the income of an Assessee. In the present case, the interest credited by the

Assessee in the books of the eligible undertaking is notional and practically unconnected with the eligible undertaking; the interest has been credited on the surplus generated, which has been transferred from the accounts of the eligible undertaking to the head office.

34. Concededly, the interest credited does not represent any real inflow of funds to the Assessee. The Assessee merely reflects inflow of funds in separate books maintained with respect to the eligible undertaking with a corresponding outflow of funds in the books maintained with respect to the head office (i.e. non-eligible undertaking).

35. In ***Commissioner Of Income-Tax vs Menon Impex P. Ltd***.: **(2003) 259 ITR 403 (Mad.)** a Division Bench of the Madras High Court considered the question, *"Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the interest income derived by the assessee from funds in connection with letter of credit is income derived from the profits of business of the industrial undertaking so as to be entitled to get the benefit of section 10A of the Income-tax Act, 1961 ?"* In that case the Assessee had set up an industrial undertaking in Kandla Free Trade Zone for manufacturing of light engineering goods. These goods were exported and in the course of business, the Assessee was required to open the letter of credit. For the said purpose, the Assessee had made deposits with banks on which it earned interest. The Court held that the interest earned by the Assessee was not

derived by the Assessee from its undertaking to which section 10A of the Act applied. The Court held that deposits made by the Assessee with banks were the source of income by way of interest and a direct nexus between interest and the undertaking could not be established. The relevant extract from the judgement is quoted below:

> "In this case the interest received by the assessee was on deposits made by it in the banks. It is that deposit which is the source of income. The mere fact that the deposit made was for the purpose of obtaining letters of credit which letters of credit were in turn used for the purpose of the business of the industrial undertaking does not establish a direct nexus between the interest and the industrial undertaking.
>
> The Tribunal, therefore, was in error in holding that there was direct nexus between the two. The question referred to us is answered in favour of the Revenue and against the assessee."

36. In ***India Comnet International Pvt. Ltd. v. Income Tax Officer***: **(2013) 354 ITR 673 (SC)**, the Supreme Court referred to the above decision and considered the case where an Assessee had claimed interest on foreign currency deposits as profits and gains exempt under Section 10A of the Act. The Supreme Court referred to the decision of the Madras High Court in ***Menon Impex P. Ltd.*** (*supra*) and remanded the matter to the Tribunal for deciding the issue whether the interest earned by the Assessee therein had a direct nexus with the business of the undertaking as was done by the Madras High Court in ***Menon Impex P. Ltd.*** *(supra).*

37. Indisputably, the interest credited by the Assessee in the books of its eligible undertaking is not earned from its business but is only a notional credit in the books on the surplus as generated by the eligible undertaking. Mr Aggarwal had sought to contest the above position by arguing that the CIT had not held the interest credited in the books of the eligible undertaking as income from other sources and, therefore, the same must be considered as profit and gains derived by the Assessee from its eligible undertaking. In our view, this contention is bereft of any merit as the CIT has proceeded on the basis that the interest credited in the books of the eligible undertaking is not the income of the Assessee at all. Therefore, the question of treating the same under the head of 'profits and gains from business' or 'income from other sources' did not arise.

38. In view of the aforesaid, the interest cannot be considered as profits and gains derived by the Assessee from the eligible undertaking as it does not bear a direct nexus with the activities of the eligible undertaking.

39. The next aspect to be considered is whether notional interest could be considered as profits and gains derived by an Assessee for the purposes of Section 10A of the Act.

40. The CIT as well as the Tribunal has referred to the decision of the Madhya Pradesh High Court in ***Malwa Mills Karamchari Parasper Sahakari Sanstha Ltd.*** (*supra*) and held that the same squarely applied to the facts of the

present case. This was stoutly disputed by Mr Aggarwal. He contended that the said decision has been rendered in the context of Section 80P of the Act, which allowed a deduction to a cooperative society in respect of profits and gains of business attributable to any of the specified activities under that Section. He further submitted that there was a difference between deductions available under Chapter VI-A - which included Section 80P - and exemptions under Chapter III of the Act. He submitted that in the case of deductions under Chapter VI-A of the Act, the total income of the Assessee is computed and, thereafter, the deductions in respect of certain incomes as are allowed; but, incomes exempt under provisions of Chapter III of the Act are excluded from the stream of total income of an Assessee at the threshold. He had also referred to Section 80AB of the Act, which in effect limits the deductions available under Chapter VI-A sub-heading C captioned "deductions in respect of certain incomes", to the extent to which such incomes are included in the gross total income of an Assessee. He submitted that no such provision exists in respect of exemptions under Chapter III of the Act.

41. We are in agreement with the Assessee's contention that under the scheme of the Act, the exemptions under Chapter III and deductions available under Chapter VI-A of the Act are qualitatively different. The incomes exempt under Chapter III of the Act are excluded from the stream of income at the threshold and the same cannot be treated as deductions available under sub-

heading C of Chapter VI-A of the Act. We are also in agreement that the deduction under Section 10A of the Act in respect of profits and gains derived from a specified source and the entire income of the eligible undertaking from the specified source is required to be excluded. However, the profits and gains must be real profits and gains derived by an Assessee and not notional or unreal income.

42. The language of Section 10A(1) of the Act must be given its plain meaning and any profits and gains derived by an Assessee from its eligible undertaking are not to be included in Assessee's total income. Plainly, such profits and gains referred to in Section 10A must mean real income of the Assessee and not fictional or notional income.

43. It is also important to note that the profits and gains which are exempt under Section 10A are not to be included in the total income of the Assessee. It would, obviously, follow that but for the exemption under Section 10A of the Act the profits and gains would be included in the total income of an Assessee. In other words, the profits and gains derived by an Assessee from an eligible undertaking - a designated source - have to be separated from the total income of the Assessee, which otherwise would subsume such income. Section 10A of the Act does not contemplate exclusion of profits and gains which are not derived by an Assessee and would not form part of the income of an Assessee.

44. In our view, the decision of this Court in ***TEI Technologies Pvt. Ltd.*** (*supra*) is of little assistance to the Assessee. The issue involved in that case was whether, for the purposes of computing the gross total income of the Assessee, the loss of non-eligible undertaking could set off against the income derived from the undertaking to which Section 10A of the Act applied. In that case, the AO had set off the loss of non-eligible unit against profits of an eligible unit and further added back disallowances to compute the gross total income of the Assessee. It is in that context that this Court had held that the income of the Assessee was to be excluded at the threshold and would not form part of the gross income of the Assessee. It is relevant to note that in that case the period involved was relevant to the assessment years 2002-03 & 2003-04; the controversy had arisen on account of the amendment to Section 10A(1) of the Act made w.e.f. 1st April, 2001, which allowed a "deduction" of profits and gains derived from an undertaking from export of articles or things or computer software. In view of the amendment, the Revenue had contended that since the expression "deduction" had been used, the gross total income of the Assessee was to be computed as per the normal provisions of the Act (without giving effect to Section 10A(1) of the Act) and, thereafter, the deduction under Section 10A(1) of the Act was to be allowed. Plainly, this controversy does not arise in the present case as the plain language of Section 10A(1) of the Act as it stood during the assessment years involved in the present case of the Act, clearly, indicated that the income of the Assessee derived from an eligible unit will have

to be excluded from the total income of the Assessee. The point in issue in the present case is not whether the profits and gains derived by the Assessee from the eligible undertaking is to be deducted after computation of the gross income of the Assessee or at the threshold, but whether, for the purposes of Section 10A of the Act, notional interest could be considered as profits and gains derived by the Assessee from the eligible undertaking.

45. In the present case, the interest so credited and debited by the Assessee in the books maintained does not, in the first instance, represent any real profit or gain by the Assessee. The Assessee has not derived any real income. Therefore, the question of deriving such profits from the eligible undertaking does not arise.

46. Section 10A if read in the manner as suggested by the Assessee, would imply that profits and gains of an Assessee from its eligible undertaking would include fictional income which is otherwise not chargeable to tax and correspondingly, the Assessee would show fictional expenditure in relation to its business, other than that falling within the scope of Section 10A, which an Assessee has not incurred.

47. This view is clearly unsustainable in law. Plainly, the Supreme Court in ***Kikabhai Premchand*** *(supra)* had explained the fundamental principle that

fictional profits could not be conjured by separating the business from their owner. The relevant passage from the said judgment is quoted below:-

> "It is well recognised that in revenue cases regard must be had to the substance of the transaction rather than to its mere form. In the present case disregarding technicalities it is impossible to get away from the fact that the business is owned and run by the assessee himself. In such circumstances we are of opinion that it is wholly unreal and artificial to separate the business from its owner and treat them as if they were separate entities trading with each other and then by means of a fictional sale introduce a fictional profit which in truth and in fact is non-existent. Cut away the fictions and you reach the position that the man is supposed to be selling to himself and thereby making a profit out of himself which on the face of it is not only absurd but against all canons of mercantile and income-tax law. And worse. He may keep it and not show a profit. He may sell it to another at a loss and cannot be taxed because he cannot be compelled to sell at a profit. But in this purely fictional sale to himself he is compelled to sell at a fictional profit when the market rises in order that he may be compelled to pay to Government a tax which is anything but fictional."

48. The aforesaid principle was followed by the Madhya Pradesh High Court in ***Malwa Mills Karamchari Parasper Sahakari Sanstha Ltd.*** (*supra*). In that case the Assessee concerned was a cooperative society and was carrying on banking business as well as business of running consumer stores. The Assessee therein had maintained separate set of books of accounts for the two business streams. During the relevant period, the consumer stores unit had credited interest in the account of the banking unit maintained in its books. Correspondingly, the banking unit had also passed entries in its books debiting the consumer stores unit with the amount of interest charged. The interest credited in the books of the banking unit was sought to be included as profits

and gains of business attributable to carrying on the business of banking. The Madhya Pradesh High Court upheld the decision of the Tribunal in reducing the profits available for deduction under Section 80P of the Act. The Court reasoned that an Assessee could not be said to have earned income from itself and, therefore, the deduction as available under Section 80P was not available to the Assessee in respect of the interest paid by the consumer stores unit to the banking unit of the Assessee. Although the said decision was rendered in the context of Section 80P of the Act, the fundamental principle that income derived by an Assessee would not include fictional profits and unreal income, would also be applicable to exemption under Section 10A of the Act. Clearly Section 10A does not contemplate income not derived by the Assessee to be reduced from the real income of the Assessee.

49. Mr Aggarwal also referred to Section 10A(6) of the Act by virtue of which the provisions of Section 80IA(8) of the Act , in so far as applicable, were also incorporated in Section 10A. He submitted that Section 80IA(8) of the Act had referred to the transfer of goods or services between eligible businesses and other businesses carried on by the Assessee and by virtue of Section 80IA(8) such transfer would be taken at market value irrespective of the prices at which such goods or services had transferred. It was submitted that this would necessarily entail one unit making a profit at the cost of another. In our view; the reliance placed on the provisions of Section 10A(6) of the Act read

with Section 80IA(8) of the Act is wholly misplaced. First of all, Section 80IA(8) only relates to transfer of goods and services between eligible and non-eligible units of an Assessee; the same does not contemplate payment and receipt of interest. Secondly - and more importantly - the said provision contains a mechanism for calculating the real income of an Assessee, which is derived from an eligible undertaking and which otherwise, forms a part of his total income. It is from the real income of the Assessee that a portion, which is derived from the eligible undertaking is excluded. The real income of an eligible undertaking is computed by evaluating the goods and services at market value. There is no scope for computing any fictional income or unreal income and assuming that the same is derived by an Assessee and further assuming that the same is derived from an eligible undertaking. Section 10A(6)/80IA(8) is a mechanism of apportioning the real income of an Assessee between the income derived from an eligible undertaking and income derived from other sources, for the purposes of excluding the income exempt under Section 10A of the Act. If the total income of the Assessee is considered (without giving effect to the exemption under Section 10A of the Act), it is at once clear that the same would not include notional interest derived from the eligible undertaking.

50. In the present case, the Assessee has not derived any interest income. Therefore, reducing such notional income – which has neither been accrued nor received – from the Assessee's total income is completely alien to the scheme

of the Act. Such notional interest could never form a part of the Assessee's income and thus the Assessee's claim that the same is to be excluded under Section 10A of the Act is flawed and wholly unsustainable in law. The view as canvassed on behalf of the Assessee is not, even remotely, plausible and we find no infirmity with the CIT's exercise of jurisdiction under Section 263 of the Act.

51. We are also unable to accept the contention that since in the preceding year, no issue has been raised with regard to charging of interest by one unit to another, the same could not be picked up by the CIT under Section 263 of the Act. Merely because an issue remained unchecked in a preceding year does not mean that the CIT is estopped from exercising its powers under Section 263 of the Act. It is well established that the principles of *res judicata* do not apply to income tax proceedings and an error in the preceding year need not be repeated or ignored in the subsequent years. The decision of this Court in ***Escorts Ltd.*** *(supra)* was based on the principle of consistency. In that case, the Assessee had been carrying on transactions similar to the one which was sought to be questioned under Section 263 of the Act, for past several years preceding the relevant assessment year. The transaction had also received the attention of the Commissioner of Income Tax in an earlier year and had been decided in favour of the Assessee. The Revenue had accepted the same and not filed an appeal. It is in that context that the Court held that since the Revenue had accepted similar

transactions in the past and had allowed a view to sustain for several years, an exercise under Section 263 of the Act was not warranted. In the present case, the issue was not picked up in the preceding year. Further, the claim of the Assessee cannot be stated to be of a nature which has been consistently accepted in past several preceding years since the entry in relation to notional interest had been passed by the Assessee only in one preceding year and had remained undebated.

52. Insofar as the question whether the Tribunal had erred in not considering the submissions relating to deduction under Section 80HHC of the Act is concerned, we are of the view that the said issue did not arise for consideration. The CIT had rightly held that the only issue under Section 263 of the Act was related to "interest charged by the head office to NEPZ Branch". He, nonetheless, proceeded to consider the alternative issue whether the turnover of the eligible undertaking (at NEPZ, Noida) could be considered for the purposes of computing exemption under Section 80HHC of the Act. Clearly, this issue did not arise as the CIT had only proposed to reduce the profits and gains claimed by the Assessee as being derived from the eligible undertaking. Thus, only question to be considered by the CIT was whether the notional interest credited in the books could be considered as income derived by the Assessee from the eligible undertaking. The Tribunal did not consider the aforesaid issue and in our view, rightly so.

53. In view of the aforesaid, the questions of law are answered in the affirmative; in favour of the Revenue and against the Assessee. The appeals are, accordingly, dismissed. The parties are left to bear their own costs.

VIBHU BAKHRU, J

S. MURALIDHAR, J

OCTOBER 09, 2015
MK/RK