

## **Incentive Deduction U/s 80-I of the I.T. Act--A Typical Example Of What One Arm Of The Government Gives, The Other Takes Away.**

( Avoidable hair -splitting by the Assessing Officers regarding the scope of the expression, “Profits and gains derived from an Industrial Undertaking” as used in Ss. 80-I & 80-IA of the IT Act )

By : S.K Tyagi

S.80-HH grants incentive to the tax-payer for establishing an industrial undertaking (I.U., for short) or a hotel in backward areas. S.80-HHA grants similar incentive for establishing small scale I.U. in certain areas. S.80-I grants incentive deduction to new I.U. started after a certain date and S.80-IA grants incentive deduction in respect of new I.U. in certain cases. What is common in all the aforesaid sections is that a certain percentage of profits and gains of an I.U. is allowed as a deduction by way of an incentive. In this context the expression, “Profits and gains derived from an Industrial Undertaking”, has generated lot of controversy. We are mainly concerned here about Ss. 80-I and 80-IA, because S. 80-I succeeds S.80-I and S.80-IA is still operative.

Now let us scan the following scenario in this context. The Ahmedabad Bench of the Income-Tax Appellate Tribunal (ITAT), in the case of Vikshara Trading and Inv. Ltd Vs. Dy.C.I.T, 99 Taxman (Mag) P.229; has held that profits on sale of import entitlements and interest on deposit kept with the bank for the grant of letter of credit (L/C) were entitled to deduction U/s 80-I. The same Bench in the case of A.C.I.T. Vs Khambhata Family Trust, 67- ITD P.411, has held that interest on deposit kept with the bank for the grant of L/C and also by way of provision for payment of disputed exercise duty, is income derived from an I.U. The Pune Bench of the ITAT, on the other hand, in the case of Dy. CIT Vs. Jagdish Electronics (P) Ltd, 66-ITD P.542, has held that interest on deposit kept with bank and private parties for establishing other I.U. was not entitled to deduction U/s 80-I and 80-HHA whereas interest on deposit kept with bank for grant of L/C is entitled to such deduction.

The Madras Bench of the ITAT in the case of Ponds Exports Ltd Vs ITO, 58-ITD P.417; in the context of S.10A, has held that interest on bank deposits could not be considered as profits and gains derived from an I.U. Similarly the Jabalpur Bench of the ITAT, in the case of Dy CIT Vs Vindhya Telelinks Ltd, 58 TTJ (Jab) P.450, has held that interest income on short term deposits with banks or the IDBI etc, is not entitled to deduction U/s 80-I or 80-HHA.

The various High Courts (H Cs) have also have been delivering divergent decisions on the issue. The Karnataka H.C. in the case of Sterling Foods Vs CIT, 150 ITR P.292; has held that the profit on sale of import entitlements cannot be treated as income derived from the I.U. On the other hand the same H C in the same case reported in 190 ITR P.275; has held a diametrically opposite view. The Kerala H C in the case of A. M Moosa, Bharat Sea Foods Vs CIT , 224 ITR P.735 ; has held that profit on sale of import entitlements is not eligible to deduction U/s 80-HH. Similarly the Madras H C in the case of CIT Vs Pandian Chemicals Ltd, 233 ITR P.497 has held that interest on deposit kept with Electricity Board, **though made under statutory compulsion**, is not profit and gain derived from the I.U.

Thus it is clear that there is sharp cleavage in judicial opinion in respect of the scope of the expression, “Profits and gains derived from an I.U.”.

On their part the Assessing Officers ( A Os) have displayed the usual ‘kill incentive’ approach, while dealing with the aforesaid issue.

## 2. Legislative History of S. 80-I

The predecessor of section 80-I was S. 80-E which was operative for assessment years ( A.Ys) 1966-67 and 1967-68 **dealing** with deduction in respect of profits and gains from specified industries in the case of certain companies. S.80-E was replaced, for and from A.Y 1968-69 by **S.80-I** S.80-I was omitted w.e.f A.Y.1973-74. Prior to such omission the deduction U/s 80-I was available to certain companies, the gross total income of which included any profits and gains ‘**attributable to**’ any priority industry. The new S.80-I was introduced in the IT Act w.e.f. 1.4.’81 i.e. A.Y. 81-82. The language used in new

S.80-I is quite different from the old S. 80-I . Under new S. 80-I deduction is allowed by way of percentage of profits and gains ‘**derived from**’ an I.U. after a certain date etc. Thus, in the old S. 80-I the relevant phrase was ‘**Attributable to**’, whereas in the new S. 80-I, it is replaced by the phrase “**Derived From**” The language of S. 80-IA is a bit different from that of S. 80-I as the expression used in S. 80-IA is “**Profits and gains derived from any business of an Industrial Undertaking etc**”. The purpose of this Article is to deal with the scope of the expression “**Profits and gains derived from an I.U**”, as used in S. 80-I and 80-IA.

## 3. Meaning of the term “Undertaking”

In order to properly appreciate the meaning of the expression “Profits and gains derived from an industrial undertaking”, it is important to correctly understand the meaning of the term in “Undertaking”. For this purpose we may take the assistance of the Law-Lexicon by Justice T P Mukherjee ( 5<sup>th</sup> Edition ). The term ‘undertaking’ as per Webster’s Dictionary, means anything undertaken, any business, work or project which one engages in or attempts; and enterprise. As per the Apex Court in the case of Banerji, A.I.R 1953 S.C. 58, the word ‘Undertaking’ must be defined as “any business or any work or project which one engages in or attempts as an enterprise analogous to business or trade”.

From the aforesaid definitions it is clear that an undertaking is like a **business unit**. Therefore any business unit which is engaged in the manufacture or production of specified items etc, will be an I.U. It implies that once a business unit is accepted as an I.U., any profits and gains earned by such business unit will be profits and gains derived from the I.U. The use of expression “profits and gains derived from any business of an I.U. etc”, in S. 80-IA; further supports the aforesaid view.

## 4. Meaning of the term ‘derived from’

For correctly understanding the term ‘derived from’ also we may take the assistance of Justice T.P.Mukherji’s Law Lexicon. The word ‘**derived**’ is not a term of art. Its use in the definition indeed demands an enquiry into the genealogy of the product. But the enquiry should stop as soon as the

effective source is discovered-CIT Vs Trivikram, A.I.R 1956 S.C. 1836, relying on C.I.T Vs K N Singh A.I.R 1949 p.1. The expression '**any income derived from property**' must be the effective source from which the income arises. It is not sufficient that the property should be indirectly responsible for the income. The income must directly and substantially arise from the property held under Trust.- I J. Trust Vs CIT, A.I.R

1953 Bom. 232.

As per the Hon. Bombay H C in the case of Hindustan Lever Ltd Vs CIT, 121 ITR P.951, the word '**derived**' as far as Income-Tax Law is concerned, has been given a narrow meaning - a strict meaning, by court and has been understood in the restricted sense of a direct derivation and not understood in the broad sense as equivalent to be derived directly or indirectly. In other words only the proximate source has to be considered and not the source to which it may ultimately be referable.

From the aforesaid definition of the term '**derived**' it again becomes clear that once a business unit is accepted as an I.U., any profits and gains earned by such a business unit will be profits and gains derived the I.U. from.

#### 5. Judicial Interpretation of the expression "Profits and gains derived from an Industrial Undertaking"

There are three important decisions delivered by the Apex Court on Ss. 80-I and 80-E. However, all these decisions relate to old S. 80-I and S.80-E, wherein the term '**Attributable to**' has been used in place of the term '**derived from**' used in new S. 80-I. These decisions are as follows :

- (i) Cambay Electric Supply Industrial Co. Ltd Vs CIT, 113 ITR P. (S.C.)
- (ii) Ashok Leyland Ltd Vs CIT 224 ITR P.122 ( S.C.); and
- (iii) Vellore Electric Corporation Ltd Vs CIT, 227 ITR p.557 ( S.C)

Amongst the aforesaid decisions of the Apex Court; the first decision in the case of Cambay Electric Supply Industrial Co. Ltd, is the most important one, as it has been followed in the latter two decisions. There are, however, some decisions of the High Courts, which have interpreted the term '**derived from**'. The relevant decisions of the Supreme Court and the High Courts are discussed as follows ;

##### (i) **Cambay Electric Supply Industrial Co. Ltd Vs CIT, 113 ITR p. 84 ( S.C.)**

The relevant part of the head note, on p.85, is reproduced as follows.

"The Legislature has deliberately used the expression '**attributable to**' having a wider import than the expression '**derived from**', thereby intending to cover receipts from sources other than the actual conduct of the business of the specified industry."

From the ratio of aforesaid decision of the Apex Court, it is clear that the phrase '**derived from**' covers receipts from the **actual conduct** of business of the specified industry. The term '**specified industry**'; here means the I.U. and not the manufacturing activity of such I.U. It may be pointed out in this context that the heading of erstwhile **S.80-E** was "Deduction in respect of profits and gains

from **specified industries** in the case of certain companies” , whereas the heading of S. 80-I is “Deduction in respect of profits and gains from industrial undertakings after certain date etc.

Thus, the words “**specified industries**” in S. 80-E, have been replaced by ‘**industrial undertakings**’ in S. 80-I. It clearly means that as per Supreme Court. decision in 113 ITR P. 84, **receipts from actual conduct of business of the industrial undertaking**, are the profits and gains derived therefrom Otherwise also the Apex Court has clearly laid down that the expression “**Attributable to**” intends to cover receipts from other sources and thereby confirming the conclusion that the expression “**derived from**” covers the receipts by way of all the profits and gains of the I.U.

In the other, words, it may be stated that all the income earned by actual conduct of business by an I.U.is entitled to deduction U/s 80-I, whereas the income from other sources is not so entitled.

(ii) **CIT Vs Eastern Sea Foods Exports Pvt Ltd, 215 ITR P.64 ( Mad. )**

This decision related to S. 80-J. The relevant part of the head note is reproduced as follows :

“ The expression ‘**derived from the business**’ in S.80-J should receive a restricted meaning and if it is an income directly relatable to the business activities of the assessee, it will be deemed to be derived from the business of the assessee”.

(iii) **Sterling Foods Vs CIT, 150 ITR P.292 (Kar.)**

This decision relates to S. 80-HH. The relevant part of the head note is reproduced as follows:

“The law requires that such profits must have been derived from the industrial undertaking. The industrial undertaking itself must be the source of that profit. The business of that industrial undertaking must directly yield that profit. It must be the direct source of that profit and not a means to earn any other profit”

(iv) **A.M.Moosa, Bharat Sea Foods Vs CIT, 224 ITR P.735 (Ker)**

This decision relates to Ss 80-HH and 80-J. The relevant part of the head note is reproduced as follows:

“ In order to claim special deduction under sections 80-HH and 80-J of the Income-Tax Act,1961, the profits should be relatable to an industrial undertaking and there has to be material to show that it is derived from the business activity relatable to such an industrial undertaking. Profit and gain can be said to have been derived from an activity carried on by a person only if the said activity is an immediate and effective source of the said profit or gain”.

(v) **CIT Vs Pandian Chemicals Ltd, 233 ITR P.497 ( Mad)**

There is a direct judgement of Madras H C in the case of C.I.T. Vs Pandian chemicals Ltd., 233 I.T.R. p.497, which has examined in depth, the meaning of the expression, ‘**derived from**’. In this

case the Hon. High Court was dealing with the deduction U/s.80HH of the Income-Tax Act. The language used in S.80-I is the same as used in S.80HH. While interpreting the correct meaning of the expression, '**derived from**' the High Court has taken into consideration almost all the case law relevant to the issue. The issue before the High court was whether interest on deposits with Electricity Board, made out of statutory compulsion, was entitled to deduction U/s. 80HH. The High Court has held that interest was not profit derived from the industrial undertaking and therefore, not entitled to deduction U/s.80HH. The relevant observations of the High Court are reproduced as follows :

- (a)“ The mandate of law is that unless the source of profit is the undertaking, the assessee is not eligible to claim deduction U/s.80HH. Mere commercial connection between the income and the industrial undertaking would not be sufficient.” - (part of Head-note p.498).
- (b)“This court has also held that the expression, '**derived from the business**' should receive a restricted meaning and it refers to an income directly relatable to the business activities of the assessee.” – ( p.504 of the Report ).
- (c)“The profits or gains eligible for deduction U/s.80HH of the Act must be derived from the actual conduct of the business and unless profits and gains are derived from the actual conduct of the business, it can not be stated that the interest is derived from the industrial undertaking.” – ( p.507 of the Report ).
- (d)“The fact that the Legislature has used the expression, 'profits and gains derived from the industrial undertaking' has some significance and it connotes that the immediate and effective source of income eligible for grant of relief U/s.80HH of the Act, must be the industrial undertaking itself and not any other source.” - ( p.507 of the Report ).
- (e)“What appears to have been intended by the Legislature is that the industrial undertaking must be the source of the profits or gains.” - ( p.507 of the Report ).

From the ratio of the aforesaid decisions of the Apex Court and the High Courts it may be easily concluded that once a business unit is accepted by the IT Dept. as an I.U., all Profits and gains earned by such a business unit, will be the profits and gains derived from the I.U. In other words such profits and gains will not include income from other source which is not earned by the actual conduct of business of the I.U.

## **6. Purpose of the incentive provision U/s 80-I and need for liberal interpretation in the light thereof**

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The purpose of S. 80-I was to provide incentive for investment in certain desired direction and promote industrialisation which would ultimately lead to more economic growth and development. The aforesaid intention of the Legislature behind the incorporation of S. 80-I in the IT Act, could be easily gauged from the CBDT's Circular No. 421, dated 12<sup>th</sup> of June 1985.

In order to understand the correct meaning of the term "**derived from**" along with the intention of the Legislature for bringing S. 80-I on the Statute, one may have to look into the relevant decisions

regarding **interpretation of the statutes**, I have already stated the purpose of S. 80-I, which is to promote industrialisation and thereby, economic growth and development. In this context the decision of the Apex Court in the case of **S.Gopal Reddy Vs State of Andhra Pradesh, J.T. 1996 (6) SC 268**, is relevant. **According to this decision a purposive approach for interpreting the Act is necessary.**

In this context another decision of the Apex Court which is in relation to present Ss. 80-I & 80-IA, in the case of **Bajaj Tempo Ltd. Vs C.I.T, 196 I.T.R. p.188(SC)**, is also quite relevant. The relevant part of the head note is as follows;

**“A provision in a taxing statute granting incentives for promoting growth and development should be construed liberally; and since a provision for promoting economic growth has to be interpreted liberally, the restriction on it, too, has to be construed so as to advance the objective of the provision and not to frustrate it”.**

Similarly the Bombay H C in the case of **C.I.T Vs Western Mechanical Industries Pvt. Ltd., 187 I.T.R p.265**, has held **that benefit given by S. 80-I to priority industries should be liberally construed to**

**carry out the objectives of the section.**

From the aforesaid decisions it is clearly established that the Assessing Officer should not indulge in unnecessary hair-splitting and place too narrow an interpretation on the provisions of S. 80-I and thereby, deny to the assesses the benefit U/s. 80-I, which has been granted by the Statute by way of an incentive.

Further even if there is an ambiguity regarding the meaning of the term **“derived from”** the Apex Court has clearly laid down that in case of doubt the court must interpret the statute in a manner favourable to the tax-payer. For this purpose reliance may be placed on the decisions of the Apex Court in the cases of **C.I.T Vs Podar Cement Pvt. Ltd., 226 I.T.R p.625** and **C.I.T Vs Shaan Finance Pvt. Ltd., etc., 231 I.T.R p.308.**

## **7. Conclusion**

In the light of the aforesaid discussion it may be safely concluded that the expression **“Profits and gain derived from an Industrial Undertaking”** used in S.80-I and 80-IA, will include all the profits and gains earned by the I.U. by the actual conduct of its business. It would mean that all the income which has a direct nexus with the business of the I.U., will be includible in such profits and gains.

The easiest and the simplest criteria in this context would be that all items of income, which are brought to tax under the head “ Profits and gains of business or profession”, in the assessment of the industrial undertaking: should qualify for the deduction U/s 80-I or 80-IA of the I.T. Act. The decision of the Karnataka H.C. in the case of Sterling Sea Foods Vs C.I.T. 190 I.T.R p.275, also supports this view.

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