REPORTABLE

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO.7622 OF 2014

COMMISSIONER OF INCOME TAX …APPELLANT

VERSUS

M/S. MEGHALAYA STEELS LTD. …RESPONDENT

WITH

CIVIL APPEAL NO.8493 OF 2012
CIVIL APPEAL NO.8494 OF 2012
CIVIL APPEAL NO.8496 OF 2012
CIVIL APPEAL NO.2560 OF 2016
(ARISING OUT OF SLP (CIVIL) NO.36578 OF 2013)
CIVIL APPEAL NO.2561 OF 2016
(ARISING OUT OF SLP (CIVIL) NO.36579 OF 2013)
CIVIL APPEAL NO.2562 OF 2016
(ARISING OUT OF SLP (CIVIL) NO.36581 OF 2013)
CIVIL APPEAL NO.2563 OF 2016
(ARISING OUT OF SLP (CIVIL) NO.37831 OF 2013)
CIVIL APPEAL NO.2564 OF 2016
(ARISING OUT OF SLP (CIVIL) NO.37833 OF 2013)
CIVIL APPEAL NO.2565 OF 2016
(ARISING OUT OF SLP (CIVIL) NO.37834 OF 2013)
CIVIL APPEAL NO.2566 OF 2016
(ARISING OUT OF SLP (CIVIL) NO.6867 (CC 224/2014)
CIVIL APPEAL NO.2567 OF 2016
(ARISING OUT OF SLP (CIVIL) NO.6869 (CC 1543/2014)

SUPREME COURT OF INDIA
JUDGMENT

CIVIL APPEAL NO.2568 OF 2016
(ARISING OUT OF SLP (CIVIL) NO.11094 OF 2014)
CIVIL APPEAL NO.2569 OF 2016
(ARISING OUT OF SLP (CIVIL) NO.11095 OF 2014)
CIVIL APPEAL NO.2570 OF 2016
(ARISING OUT OF SLP (CIVIL) NO.12710 OF 2014)
CIVIL APPEAL NO.3624 OF 2015
CIVIL APPEAL NO.2571 OF 2016
(ARISING OUT OF SLP (CIVIL) NO.24620 OF 2014)
CIVIL APPEAL NO.2572 OF 2016
(ARISING OUT OF SLP (CIVIL) NO.11319 OF 2015)
CIVIL APPEAL NO.3623 OF 2015
CIVIL APPEAL NO.5238 OF 2015
CIVIL APPEAL NO.5239 OF 2015
CIVIL APPEAL NO.5236 OF 2015
CIVIL APPEAL NO.6040 OF 2015
CIVIL APPEAL NO.6039 OF 2015
CIVIL APPEAL NO.7623 OF 2014
CIVIL APPEAL NO.7624 OF 2014

J U D G M E N T

R.F. Nariman, J.

JUDGMENT

1. Delay condoned in filing the special leave petitions.

2. Leave granted in SLP (C) Nos. 36578/2013, 36579/2013, 36581/2013, 37831/2013, 37833/2013, 37834/2013, SLP(C) No.……CC No.224/2014), SLP(C) No.……CC

No.1543/2014), SLP(C) Nos.11094/2014, 11095/2014, 12710/2014, 24620/2014, 11319/2015.

3. This group of appeals arises from the State of Meghalaya and concerns deductions to be made under Sections 80-IB and 80-IC of the Income Tax Act, 1961. Civil Appeal No.7622 of 2014 has been treated as the lead matter in which a judgment of the Gauhati High Court dated 29.5.2013 has been delivered, which has been followed in all the other appeals.

4. Civil Appeal No.7622 of 2014 concerns itself with two income tax appeals filed by the Revenue against the judgment of the Income Tax Appellate Tribunal, ITA No.7/2010 arising out of the applicability of Section 80-IB, and ITA No.16/2011 arising out of the applicability of Section 80-IC. For the purpose of these matters, the facts in ITA No.7/2010 are narrated hereinbelow.

5. The respondent is engaged in the business of manufacture of Steel and Ferro Silicon. On 9.10.2014, the Respondent submitted its return of income for the year 2004-

2005 disclosing an income of Rs.2,06,970/- after claiming deduction under Section 80-IB of the Income Tax Act on the profits and gains of business of the respondent's industrial undertaking. The respondent had received the following amounts on account of subsidies:-

Transport subsidy -	Rs.2,64,94,817.00
Interest subsidy -	Rs.2,14,569.00
Power subsidy -	Rs.7,00,000.00
Total -	Rs.2,74,09,386.00

6. The Assessing Officer, in the assessment order dated 7.12.2006, held that the amounts received by the assessee as subsidies were revenue receipts and did not qualify for deduction under Section 80-IB(4) of the Act and, accordingly, the respondent's claim for deduction of an amount of Rs.2,74,09,386/- on account of the three subsidies afore-mentioned were disallowed. The respondent-assessee preferred an appeal before the Commissioner of Income Tax (Appeals), Guwahati, who, vide his order dated 8.3.2007, dismissed the appeal of the respondent. Aggrieved by the

aforesaid order, the respondent preferred an appeal before the ITAT which, by its order dated 19.3.2010, allowed the appeal of the respondent. The Revenue carried the matter thereafter to the High Court, under Section 260A of the Act, which resulted in the impugned judgment dated 29.5.2013, which decided the matter against the Revenue. Revenue is therefore before us in appeal against this judgment.

7. Shri Radhakrishnan, learned senior advocate appearing on behalf of the Revenue, argued before us that any amount received by way of subsidy was an amount whose source was the Government and not the business of the assessee. He further argued that there is a world of difference between the expression profits and gains "derived from" any business, and profits "attributable to" any business, and that since the section speaks of profits and gains "derived from" any business, such profits and gains must have a close and direct nexus with the business of the assessee. Subsidies that are allowed to the assessee have no close and direct nexus with the business of the assessee but have a close and direct nexus with grants

from the Government. This being the case, according to him, the respondent did not qualify for deductions under Sections 80-IB and 80-IC of the Act. In the course of his lengthy submissions, he made reference to a number of judgments including the judgment reported as **Liberty India v. Commissioner of Income Tax** reported in 2009 (9) SCC 328, which has been followed by the Himachal Pradesh High Court in **Supriya Gill v. CIT** (2010) 193 Taxman 12 (Himachal Pradesh). He submitted that the aforesaid judgment of the Himachal Pradesh High Court has taken a diametrically opposite view to the judgment of the Gauhati High Court, impugned in the present appeals, and deserves to be followed, as it, in turn, has followed **Liberty India's** judgment and another Supreme Court judgment reported as **CIT v. Sterling Foods,** 237 ITR 579 (1999). He also relied upon Sections 80-A and 80-AB in order to demonstrate the scheme of deductions allowable under Part-VI-A of the Income Tax Act. He also referred us to Sections 56 and 57 (iii) of the Act to buttress his submission that subsidies being in the nature of "income from other sources" could not be allowed to be deducted from profits

and gains of business, which fell under a different sub-heading in Section 14 of the Act. According to him, there is one interpretation and one interpretation alone of Sections 80-IB and 80-IC, which cannot be deviated from with reference to any so-called object of the said sections.

8. Countering these submissions, Shri P. Chidambaram Learned Senior Counsel appearing on behalf of the assessee, referred to the Budget Speech of the Minister of Finance for 1999-2000 to buttress his submission that the idea of giving these subsidies was to give a 10 year tax holiday to those who come from outside Meghalaya to set up industries in that State, which is a backward area. He referred to several judgments, including the judgment reported in **Jai Bhagwan Oil and Flour Mills v. Union of India and Others** (2009) 14 SCC 63 and **Sahney Steel and Press Works Ltd. v. Commissioner of Income Tax, A.P. - I, Hyderabad,** (1997) 7 SCC 764 to buttress his submission that subsidies were given only in order that items which would go into the cost of manufacture of the products made by the respondent should be reduced, as these

subsidies were reimbursement for either the entire or partial costs incurred by the respondent towards transporting raw materials to its factory and transporting its finished products to dealers, who then sell the finished products. Further, power subsidy, interest subsidy and insurance subsidy were also reimbursed, either wholly or partially, power being a necessary element of the cost of manufacture of the respondent's products, and insurance subsidy being necessary to defray costs for both manufacture and sale of the said products. Further, interest subsidy would also go towards reducing the interest element relatable to cost, and therefore all four subsidies being directly relatable to cost of manufacture and/or sale would therefore necessarily fall within the language of Sections 80-IB and 80-IC, as they are components of cost of running a business from which profits and gains are derived. He sought to distinguish the judgments cited by Shri Radhakrishnan, in particular the judgment of this Court in **Liberty India**, on the ground that the said judgment did not deal with a subsidy relatable to cost of manufacture but dealt with a DEPB drawback scheme, which related to export of goods and

not manufacture of goods, thereby rendering the said decision inapplicable to the facts of the present case. Shri S. Ganesh, learned senior counsel appearing on behalf of some of the respondent-assessees, reiterated the submissions made by Shri P. Chidambaram and added that as all the subsidies went towards cost of manufacture or sale of the products of the respondent, such subsidies being amounts of cost which were actually incurred by the respondent and thereafter reimbursed by the State, the principle of netting off recognized in several decisions of this Court ought to be applied, and on application of the said principle, it is clear that the subsidy received by the respondent was only to depress cost of manufacture and/or sale and would therefore be "derived from" profits and gains made from the business of the assessee. He also relied upon a judgment of the Calcutta High Court dated 15.1.2015, in **C.I.T. v. Cement Manufacturing Company Limited,** which has followed the Gauhati High Court, and a judgment of the Delhi High Court in **CIT v. Dharampal Premchand Ltd**., 317 ITR 353.

9. We have heard learned counsel for the parties. Before embarking on a discussion of the relevant case law, we think it is necessary to set out Sections 80-IB and 80-IC insofar as they are relevant for the determination of the present case.

> **"80-IB Deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings**
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> (1) Where the gross total income of an assessee includes any profits and gains derived from any business referred to in sub-sections (3) to (11), (11A) and (11B) (such business being hereinafter referred to as the eligible business), there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction from such profits and gains of an amount equal to such percentage and for such number of assessment years as specified in this section.
>
> (2) This section applies to any industrial undertaking which fulfils all the following conditions, namely:-
> (i) it is not formed by splitting up, or the reconstruction, of a business already in existence:
> Provided that this condition shall not apply in respect of an industrial undertaking which is formed as a result of the re-establishment, 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;
> (ii) it is not formed by the transfer to a new business of machinery or plant previously used for any purpose;

(iii) it manufactures or produces any article or thing, not being any article or thing specified in the list in the Eleventh Schedule, or operates one or more cold storage plant or plants, in any part of India:

Provided that the condition in this clause shall, in relation to a small scale industrial undertaking or an industrial undertaking referred to in sub-section (4) shall apply as if the words "not being any article or thing specified in the list in the Eleventh Schedule" had been omitted.

Explanation 1- For the purposes of clause (ii), any machinery or plant which was used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose, if the following conditions are fulfilled, namely:-

(a) such machinery or plant was not, at any time previous to the date of the installation by the assessee, used in India;

(b) such machinery or plant is imported into India from any country outside India; and

(c) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of this Act in computing the total income of any person for any period prior to the date of the installation of the machinery or plant by the assessee.

Explanation 2- Where in the case of an industrial undertaking, any machinery or plant or any part thereof previously used for any purpose is transferred to a new business and the total value of the machinery or plant or part so transferred does not exceed twenty per cent of the total value of the machinery or plant used in the business, then, for the purposes of clause (ii) of this sub-section, the condition specified therein shall be deemed to have been complied with;

(iv) in a case where the industrial undertaking manufactures or produces articles or things, the undertaking employs ten or more workers in a

manufacturing process carried on with the aid of power, or employs twenty or more workers in a manufacturing process carried on without the aid of power.

(4) The amount of deduction in the case of an industrial undertaking in an industrially backward State specified in the Eighth Schedule shall be hundred per cent of the profits and gains derived from such industrial undertaking for five assessment years beginning with the initial assessment year and thereafter twenty-five per cent (or thirty per cent where the assessee is a company) of the profits and gains derived from such industrial undertaking:
Provided that the total period of deduction does not exceed ten consecutive assessment years (or twelve consecutive assessment years where the assessee is a co-operative society) subject to fulfillment of the condition that it begins to manufacture or produce articles or things or to operate its cold storage plant or plants during the period beginning on the 1st day of April, 1993 and ending on the 31st day of March, 2004:
Provided further that in the case of such industries in the North-Eastern Region, as may be notified by the Central Government, the amount of deduction shall be hundred per cent of profits and gains for a period of ten assessment years, and the total period of deduction shall in such a case not exceed ten assessment years.
Provided also that no deduction under this sub-section shall be allowed for the assessment year beginning on the 1st day of April, 2004 or any subsequent year to any undertaking or enterprise referred to in sub-section (2) of section 80-IC.
Provided also that in the case of an industrial undertaking in the State of Jammu and Kashmir, the provisions of the first proviso shall have effect as if for the figures, letters and words 31st day of March,

2004, the figures, letters and words 31st day of March, 2012 had been substituted:
Provided also that no deduction under this sub-section shall be allowed to an industrial undertaking in the State of Jammu and Kashmir which is engaged in the manufacture or production of any article or thing specified in Part C of the Thirteenth Schedule."

"80-IC Special provisions in respect of certain undertakings or enterprises in certain special category States

(1) Where the gross total income of an assessee includes any profits and gains derived by an undertaking or an enterprise from any business referred to in sub-section (2), there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction from such profits and gains, as specified in sub-section (3)."

10. There is no dispute between the parties that the businesses referred to in Section 80-IB are businesses which are eligible businesses under both the aforesaid Sections. The parties have only locked horns on the meaning of the expression "any profits and gains derived from any business".

11. The aforesaid provisions were inserted by the Finance Act 1999 with effect from 1.4.2000. The Finance Minister in his

budget speech for the year 1999-2000 spoke about industrial development in the North Eastern Region as follows:-

> "Mr. Speaker, Sir, I am conscious of the fact that, despite all our announcements, the industrial development in North Eastern Region has not come up to our expectations. To give industrialisation a fillip in this area of the country, I propose a 10 year tax holiday for all industries set up in Growth Centres, Industrial Infrastructure Development Corporations, and for other specified industries, in the North Eastern Region. I would urge the industrial entrepreneurs from this part of the country to seize the opportunity and set up modern, high value added manufacturing units in the region."

12. The reference to the 10 year tax holiday for the industries set up in the North Eastern Region is an obvious reference to the second proviso to sub-section (4) of Section 80-IB set out hereinabove. The speech of a Minister is relevant insofar it gives the background for the introduction of a particular provision in the Income Tax Act. It is not determinative of the construction of the said provision, but gives the reader an idea as to what was in the Minister's mind when he sought to introduce the said provision. As an external aid to construction, this Court has, in **K.P. Varghese v. Income Tax Officer,**

Ernakulam and Anr., (1982) 1 SCR 629, referring to a Minister's speech piloting a Finance Bill, stated as under:-

> "Now it is true that the speeches made by the Members of the Legislature on the floor of the House when a Bill for enacting a statutory provision is being debated are inadmissible for the purpose of interpreting the statutory provision but the speech made by the Mover of the Bill explaining the reason for the introduction of the Bill can certainly be referred to for the purpose of ascertaining the mischief sought to be remedied by the legislation and the object and purpose for which the legislation is enacted. This is in accord with the recent trend in juristic thought not only in Western countries but also in India that interpretation of a statute being an exercise in the ascertainment of meaning, everything which is logically relevant should be admissible. In fact there are at least three decisions of this Court, one in Loka Shikshana Trust v. Commissioner of Income-Tax [1975] 101 ITR 234(SC) the other in Indian Chamber of Commerce v. Commissioner of Income-tax [1975] 101 ITR 796(SC) and the third in Additional Commissioner of Income-tax v. Surat Art Silk Cloth Manufacturers Association [1980] 121 ITR 1(SC) where the speech made by the Finance Minister while introducing the exclusionary clause in Section 2 Clause (15) of the Act was relied upon by the Court for the purpose of ascertaining what was the reason for introducing that clause. The speech made by the Finance Minister while moving the amendment introducing Sub-section (2) clearly states what were the circumstances in which Sub-section (2) came to be passed, what was the mischief for which Section 52 as it then stood did not provide and which was sought to be remedied by the enactment of Sub-section (2) and why the enactment of Sub-section

(2) was found necessary. It is apparent from the speech of the Finance Minister that Sub-section(2) was enacted for the purpose of reaching those cases where there was under-statement of consideration in respect of the transfer or to put it differently, the actual consideration received for the transfer was 'considerably more' than that declared or shown by the assessee, but which were not covered by Sub-section (1) because the transferee was not directly or indirectly connected with the assessee. The object and purpose of Sub-section (2), as explicated from the speech of the Finance Minister, was not to strike at honest and bonafide transactions where the consideration for the transfer was correctly disclosed by the assessee but to bring within the net of taxation those transactions where the consideration in respect of the transfer was shown at a lesser figure than that actually received by the assessee, so that they do not escape the charge of tax on capital gains by under-statement of the consideration. This was real object and purpose of the enactment of Sub-section (2) and the interpretation of this sub-section must fall in line with the advancement of that object and purpose. We must therefore accept as the underlying assumption of Sub-section (2) that there is under-statement of consideration in respect of the transfer and Sub-section (2) applies only where the actual consideration received by the assessee is not disclosed and the consideration declared in respect of the transfer is shown at a lesser figure than that actually received."

13. A series of decisions have made a distinction between "profit attributable to" and "profit derived from" a business. In one of the early judgments, namely, **Cambay Electric Supply**

Industrial Company Limited v. Commissioner of Income Tax, Gujarat II, (1978) 2 SCC 644, this Court had to construe Section 80-E of the Income Tax Act, which referred to profits and gains attributable to the business of generation or distribution of electricity. This Court held:

> "As regards the aspect emerging from the expression "attributable to" occurring in the phrase "profits and gains attributable to the business of" the specified industry (here generation and distribution of electricity) on which the learned Solicitor General relied, it will be pertinent to observe that the Legislature has deliberately used the expression "attributable to" and not the expression "derived from". It cannot be disputed that the expression "attributable to" is certainly wider in import than the expression "derived from". Had the expression "derived from" been used it could have with some force been contended that a balancing charge arising from the sale of old machinery and buildings cannot be regarded as profits and gains derived from the conduct of the business of generation and distribution of electricity. In this connection it may be pointed out that whenever the Legislature wanted to give a restricted meaning in the manner suggested by the learned Solicitor General it has used the expression "derived from", as for instance in s. 80J. In our view since the expression of wider import, namely, "attributable to" has been used, the Legislature intended to cover receipts from sources other than the actual conduct of the business of generation and distribution of electricity." (Para 8)

14. In **Commissioner Of Income Tax, Karnataka v. Sterling Foods, Mangalore,** (1999) 4 SCC 98, this Court had to decide whether income derived by the assessee by sale of import entitlements on export being made, was profit and gain derived from the respondent's industrial undertaking under Section 80HH of the Indian Income Tax Act. This Court referred to the judgment in **Cambay Electric Supply** (supra) and emphasized the difference between the wider expression "attributable to" as contrasted with "derived from". In the course of the judgment, this Court stated that the industrial undertaking itself had to be the source of the profit. The business of the industrial undertaking had directly to yield that profit. Having said this, this Court finally held:-

> "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 Govt. 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 assessees' industrial undertaking." (Para 13)

15. Similarly, in **Pandian Chemicals Limited v Commissioner of Income Tax,** 262 ITR 278, this Court dealt with the claim for a deduction under Section 80HH of the Act. The question before the Court was as to whether interest earned on a deposit made with the Electricity Board for the supply of electricity to the appellant's industrial undertaking should be treated as income derived from the industrial undertaking under Section 80HH. This Court held that although electricity may be required for the purposes of the industrial undertaking, the deposit required for its supply is a step removed from the business of the industrial undertaking. The derivation of profits on the deposit made with the Electricity Board could not be said to flow directly from the industrial undertaking itself. On this basis, the appeal was decided in favour of Revenue.

16. The sheet anchor of Shri Radhakrishnan's submissions is the judgment of this Court in **Liberty India v. Commissioner of Income Tax,** (2009) 9 SCC 328. This was a case referring directly to Section 80-IB in which the question was whether DEPB credit or Duty drawback receipt could be said to be in respect of profits and gains derived from an eligible business. This Court first made the distinction between "attributable to" and "derived from" stating that the latter expression is narrower in connotation as compared to the former. This court further went on to state that by using the expression "derived from" Parliament intended to cover sources not beyond the first degree. This Court went on to hold:-

> "34. On an analysis of Sections 80-IA and 80-IB it becomes clear that any industrial undertaking, which becomes eligible on satisfying sub-section(2), would be entitled to deduction under sub-section (1) only to the extent of profits derived from such industrial undertaking after specified date(s). Hence, apart from eligibility, sub-section (1) purports to restrict the quantum of deduction to a specified percentage of profits. This is the importance of the words "derived from industrial undertaking" as against "profits attributable to industrial undertaking".
>
> 35. DEPB is an incentive. It is given under Duty Exemption Remission Scheme. Essentially, it is an

export incentive. No doubt, the object behind DEPB is to neutralize the incidence of customs duty payment on the import content of export product. This neutralization is provided for by credit to customs duty against export product. Under DEPB, an exporter may apply for credit as percentage of FOB value of exports made in freely convertible currency. Credit is available only against the export product and at rates specified by DGFT for import of raw materials, components etc.. DEPB credit under the Scheme has to be calculated by taking into account the deemed import content of the export product as per basic customs duty and special additional duty payable on such deemed imports.

36. Therefore, in our view, DEPB/Duty Drawback are incentives which flow from the Schemes framed by Central Government or from S. 75 of the Customs Act, 1962, hence, incentives profits are not profits derived from the eligible business under Section 80-IB. They belong to the category of ancillary profits of such Undertakings." (Paras 34,35 and 36)

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 Company Limited v Commissioner of Income Tax, Gujarat II,** 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** 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 Limited v Commissioner of Income Tax** 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** 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 **Merino Ply & Chemicals Ltd. v. CIT,** 209 ITR 508 [1994], 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.**, 242 ITR 204 [2000], 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 **C.I.T. v. Cement Manufacturing Company Limited**, by a judgment dated 15.1.2015, distinguished the judgment in **CIT v. Andaman Timber Industries Ltd**. 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 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.
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> 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 **Merino Ply & Chemicals Ltd.** 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 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. v. Commissioner of Income Tax, A.P. - I, Hyderabad** (1997) 7 SCC 764, 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.

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27. A Delhi High Court judgment was also cited before us being **CIT v. Dharampal Premchand Ltd**., 317 ITR 353 from which an SLP preferred in the Supreme Court was dismissed. This judgment also concerned itself with Section 80-IB of the Act, in which it was held that refund of excise duty should not be excluded in arriving at the profit derived from business for

the purpose of claiming deduction under Section 80-IB of the Act.

28. It only remains to consider one further argument by Shri Radhakrishnan. He has argued that as the subsidies that are received by the respondent, would be income from other sources referable to Section 56 of the Income Tax Act, any deduction that is to be made, can only be made from income from other sources and not from profits and gains of business, which is a separate and distinct head as recognised by Section 14 of the Income Tax Act. Shri Radhakrishnan is not correct in his submission that assistance by way of subsidies which are reimbursed on the incurring of costs relatable to a business, are under the head "income from other sources", which is a residuary head of income that can be availed only if income does not fall under any of the other four heads of income. Section 28(iii)(b) specifically states that income from cash assistance, by whatever name called, received or receivable by any person against exports under any scheme of the Government of India, will be income chargeable to income tax

under the head “profits and gains of business or profession”. If cash assistance received or receivable against exports schemes are included as being income under the head “profits and gains of business or profession”, it is obvious that subsidies which go to reimbursement of cost in the production of goods of a particular business would also have to be included under the head “profits and gains of business or profession”, and not under the head “income from other sources”.

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** and **Liberty India** 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.

……J.
(Kurian Joseph)

……J.
(R.F. Nariman)

New Delhi;
March 09, 2016.

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