$~9, 10, 13 & 14

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

DECIDED ON: 11.09.2012

\+ **ITA Nos.278, 807, 1578 & 312/2010**

COMMISSIONER OF INCOME TAX ..... Appellant
Through: Mr. Abhishek Maratha, Sr. Standing Counsel with Ms. Anshul Sharma, Advocate.

versus

BHARAT HEAVY ELECTRICAL LIMITED ..... Respondent
Through: Mr. S. Krishnan, Advocate.

CORAM:
MR. JUSTICE S. RAVINDRA BHAT
MR. JUSTICE R.V. EASWAR

MR. JUSTICE S.RAVINDRA BHAT (OPEN COURT)

% These appeals by the Revenue assail the decision/order of the ITAT dated 27.2.2009 (in ITA-2709/Del/92) and the common order dated 30.3.2009 in ITA Nos,3214/Del/93, 7062/Del/92 and 2029/Del/02 dated 20.3.2009.

2. The substantial questions of law which arise are as follows: -

(1) Whether the provisions made claiming deduction for wage revision, allowed by the Tribunal was justified in the circumstances of the case (arising in ITA 312/2010 and 807/2010)?

(2) Whether the interest earned on tax free bonds between the date of their application by the assessee and the date

of their allotment could be given the benefit claimed under Section 10 (15) (iv) (h) (arising in ITA 312/2010)?

(3) Whether the expenditure allowed by the impugned order of the Tribunal was justified in respect of the donations made by the assessee and claimed as business expenses under Section 37(1) (arising in ITA-1578/2010 and 278/2010)?

(4) Whether the Tribunal fell into error in holding that loss of one project eligible for deduction under Section-80 HHB could not be set of against the profits of other projects eligible under the same provision (arising in ITA 1578/2010 and 278/2010)?

3. *Question No.1 – Whether the provisions made claiming deduction for wage revision, allowed by the Tribunal was justified in the circumstances of the case?*

The assessee, BHEL, had during the relevant assessment years 1988-89 and 1998-99 claimed, in its schedule in the balance sheet, addition of its liability on account of wage revision. Accordingly, a provision for wage revision was factored. The assessee submitted that even though the wage revision proposals had been submitted to the competent bodies or authorities, the liability was certain and ascertained on the basis of its past experience and after taking into consideration the previous Pay Commission's reports, union demands and the ability of the employer to bear the additional burden. These provisions also took into account factors such as price index in

adjustment inflation etc. The assessee, a public sector unit, had stated that since the liability being ascertained, even the Comptroller and Auditor General had not communicated them to be contingent liabilities. The Assessing Officer, for both the relevant years, held that the provision could not be allowed and that the claim or deduction was allowable when actually the entire quantum of liability could be calculated. The order of the AO was upheld in appeal. The Tribunal relying the Supreme Court's decision in *CIT vs. Bharat Earth Movers*, 245 ITR 428 allowed the assessee's claim. The Tribunal noticed as follows: -

> *"13. In the assessee's case also, it is noticed that the provision for the wage revision is factored on the basis of past experience, interim pay commissions of govt. employees, available pay commission reports of public sector employees, union demands and other relevant factors required for a scientific computation. Obviously, when one wage agreement comes to an end and other is executed, there would be a passage of time, but the new wage agreement would come into effect from the end of the earlier wage agreement. This being so, the liability is certain in the assessee's case though the quantum of such liability is variable and it is further noticed that the assessee has categorically admitted that the provision as done is invariable short of the final agreement and the difference as ultimately emerging are always booked as expenses in the year in which the payment is made. This being so, we are of the view that the provisions made on account of wage revision is not a contingent liability and is allowable in the year of making such provisions made. In the circumstances, this issue is held in favour of the assessee and the addition on this account stands deleted."*

4. Learned counsel for the Revenue contended that the deduction for wage revision allowed by the Tribunal cannot be sustained because the exact liability was unascertainable. The deduction could be allowed only when the liability can actually be counted in discharge, which in this case was on a future date. Furthermore, urged counsel, that even if the assessee's contention about estimation of the liability were to be accepted, that exercise had to be based on realistic and reasonable calculations, even though actual quantification may not be possible.

5. In the earliest decision on the question of whether such liability incurred towards employees' services or fulfillment of their terms of employment which may become payable in future but claimed by the assessee in a given previous year is allowable as deduction, the Supreme Court observed as follows in *Metal Box Company of India Ltd. v. Their Workmen*, 73 (1969) ITR 53: -

> *"The question that concerns us is whether, while working out the net profits, a trader can provide from his gross receipts his liability to pay a certain sum for every additional year of service which he receives from his employees. This, in our view, he can do, if such liability is properly ascertainable and it is possible to arrive at a proper discounted present value. Even if the liability is contingent liability, provided its discounted present value is ascertainable, it can be taken into account. Contingent liabilities discounted and valued as necessary can be taken into account as trading expenses if they are sufficiently certain to be capable of valuation and if profits cannot be properly estimated without taking them into account. Contingent rights, if capable of valuation, can*

> *similarly be taken into account as trading receipts where it is necessary to do so in order to ascertain the true profits."*

In *Bharat Earth Movers (supra)* (decided by the Supreme Court), the question which the Court had to consider was whether the provision for meeting earned-leave-encashment by the employee was an admissible deduction in the hands of the employer. The Court reiterated and applied its previous decision in *Metal Box' case (supra)* and held as follows:

> *"(I)f a business liability has definitely arisen in the accounting year, the deduction should be allowed although the liability may have to quantify and discharge at a future date. What should be certain is the incurring of the liability. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible. If these requirements are satisfied, the liability is not a contingent one. The liability is in praesenti though it will be discharged at a future date. It does not make any difference if the future date on which the liability shall have to be discharged is not certain."*

6. In this case, the Tribunal had noticed that there was no dispute as regards the terms of employment of the workers and officers. The only question was the exact quantification of the compensation or wage revision. The Tribunal also held that provision for wage revision was based on past experience, interim Pay Commission of government employees, previous Pay Commission's reports of public sector employees, union demands and other relevant factors. The Tribunal also held that with the expiry of one wage settlement or

agreement, invariably, there is a time lag when another fresh wage revision agreement is negotiated and entered. The deduction claimed for that period cannot be termed as contingent because the wage and the probable revision or rates of revision would be within the fair estimation of the employer. In this case, BHEL had the benefit of past experience of such pay revisions. Its liability could not be characterized as contingent but was in fact ascertained; the quantification, however, had not happened.

7. In view of these facts, this Court holds that there is no infirmity with the reasoning of the Tribunal about the deduction claimed on account of wage revision being permissible.

8. *Question No.2 – Whether the interest earned on tax free bonds between the date of their application by the assessee and the date of their allotment could be given the benefit claimed?*

This question arises for consideration only for the assessment year 1988-89. The assessee had earned ₹ 25 lacs which was credited to its interest account. The facts are that the assessee had applied for and was allotted tax free bonds during the relevant period. The interest sought to be taxed was for the period between the date of submission of application along with the money to the issuing agency i.e. the Railways and actual allotment. In the opinion of the AO and the Appellate Commissioner (who affirmed the former's decision), the character of the income i.e. interest for that period i.e. between the date of application and the date of allotment of bonds was different and it could not claim the benefit of exemption.

9. In support of the appeal, it was argued that the Tribunal fell into error in holding that interest for the brief period when the bonds were not allotted, could not be taxed. It was submitted that in terms of the bonds applied for, interest was payable from the date of allotment. Interest income was exempted from the date of allotment till the date of maturity even though the concerned agency might have paid interest for the period before the allotment, that interest income could not claim the benefit of exemption.

10. The Tribunal by its impugned order reasoned while accepting the assessee's appeal as follows: -

> *"50. We have considered the rival submissions. It is noticed that the benefit of deduction u/s 10 (15) (iv) (h) is available to the various specified/notified bonds/debentures. Further, the reading of the Explanation 2 to the said section also shows that the expression interest has been widened so that the benefit of exemption from withholding of tax is also extended to hedging transaction charges on account of currency fluctuation. This clearly shows that the interest on the bonds whether embedded in bonds subsequent to its purchase is also exempt. This being so, we are of the view that the disallowance as made by the AO and as confirmed by the CIT (A) on this ground is not on right footing and is liable to be reversed and we do so. In the circumstances, the AO is directed to grant the assessee the benefit of the deduction of the interest of Rs.25 lakh which has fallen due in connection with the transaction of the purchase of the tax free bonds. In the circumstances, this issue is held in favour of the assessee and stands allowed."*

11. Section 10 lists out all kinds of amounts and income which are not taxable. Section 10(15)(iv) to the extent it is relevant reads as follows: -

> *"(I)nterest payable –*
> *XXX*
> *(h) by any public sector company in respect of such bonds or debentures and subject to such conditions including the condition that the "holder of such bonds or debentures register its name and the holding with that company as the Central Government may by Notification in the Official Gazette specified in this behalf".*

12. A juxtaposition of the terms "interest payable …… on monies" [apparent from Section 10(15)(iv)(a), (b), (c), (e) and (f)], on one hand, with the term "interest payable…….. by a public sector company in respect of such bonds…….", on the other, would reveal a different intention in dealing with the kind of deposit envisioned in Section 10(15)(1)(iv)(h). Interest payable on "bonds or deposits" [referred to Section 10(15)(1)(iv)(fa)] would mean interest earned by such amount or deposit. On the other hand, interest paid in respect of such bonds, as is the case with tax free interest bonds under sub-section 15(1)(iv)(h), connotes an entirely different intention. The expression "in respect of," unlike the term "on," has a wider connotation and would embrace a larger subject matter. On the other hand, "interest … on the bond or deposit" would mean what is actually yielded by the bonds and nothing else. The Tribunal noticed - and in our opinion - correctly - that interest would include hedging transaction charges payable on account of currency fluctuation. Such

being the amplitude of the provision, the fact that interest was paid for a brief period of about six days in the present case would not make it any less an amount of interest payable "in respect of the bonds" in question. If, in fact, the assessee had sought to claim the benefit of tax exemption for a larger period and there were some material on record to show that the amount deposited towards the bond and kept for that purpose was for an unreasonably long period of time, the conclusion by the AO might have been justified. In this case, the time lag is extremely small less than a week.

13. Having regard to these circumstances and the intendment of the statute which was to generally exempt such kind of income, this Court is satisfied that the Tribunal's order on this aspect does not call for any interference.

14. *Question No.3 - Whether the expenditure allowed by the impugned order of the Tribunal was justified in respect of the donations made by the assessee and claimed as business expenses under Section-37 (1)?*

The assessee had claimed expenditure on account of donations under section 80G of the Act in its returns. It had submitted that donations were given to various organizations which were laid out or expanded exclusively for business purposes. These donations were mostly made for the purpose of promoting education and had special relevance since the assessee had units in townships or places where access to school was extremely limited. The general object of educational welfare being undoubtedly charitable, and linked with the well being of the assessee's employees, the expenditure was correctly

allowed under section 37(1). The AO and the CIT had disallowed the claim originally made under section 80G. The reasoning of these two lower authorities was that the claim was unsupported by any documentary proof with regard to the permissibility of the deduction and such being the case, relief of larger deduction as business expenditure could not be granted.

15. The Tribunal accepted the assessee's argument and held that the payments were made for the purpose of efficient running of business as the establishment of assessee functions at various remote places and was for the purpose of securing local support. Furthermore, the Tribunal was persuaded to uphold the assessee's claim on the ground that the assessee's employees were also local residents and that such support by promoting welfare, was a business expenditure. The learned counsel for the assessee supported the decision of the Tribunal and also placed reliance upon the judgment in *CIT v. Madras Refineries Ltd.* 2004 (266) ITR 170.

16. There can be no two opinions that any expenditure which is laid out exclusively for business purpose and to facilitate profits, and which does not otherwise become permissible under specific sections, can qualify for deduction. In this case, however, the assessee claimed a limited deduction under Section 80G. It was unable to satisfy the AO with documentary evidence that the organizations or Trusts or Societies it donated the amounts to, had the requisite approval. The necessary certificates to claim deductions under Section 80G were not forthcoming, neither during the assessment nor in the appellate proceedings. Before the Tribunal, the assessee appears to have argued

that what it claimed as a limited permissible deduction by virtue of Section 80G, and which was not granted on account of lack of evidence, could be enlarged as business expenditure in entirety under Section 37(1). This Court is unpersuaded by the logic and reasoning of the Tribunal. There is absolutely no documentary evidence to show that the amounts involved (which are quite substantial) could be deemed necessary or expedient to promote the assessee's business. While the philanthropic activity such as donation are laudable and, in principle, cannot be faulted; however, parting with of large amounts to "gain local support," *per se* cannot constitute deductible business expenditure. For the assessee to have successfully made a claim in terms of section 37 (1), it was not enough for it to assert the general charitable public welfare benefits that potentially would accrue as a consequence of such donations. It had to show the particulars of the organizations which were beneficiaries of such donations and also the corresponding expedience in making out such donations. The danger in promoting such expenditure as having been "laid out" exclusively for business purposes is that it can well degenerate into an exercise of unregulated activity for which the Revenue would perforce defer to the assessee's decision on the basis of no discernable principle. Parliament having chosen one method of dealing with donations i.e. as in the case of section 80G, the adoption of another route as business expenditure would not be permissible.

17. For the above reasons, the Revenue's appeals have to succeed on this point. The amounts claimed as business expenditure for the relevant assessment years have to be added back and brought to tax.

18. *Question No.4 (Whether the Tribunal fell into error in holding that losses of one project claiming deduction under Section-80 HHB could not be set of against the profits of other projects under the same provision).*

The assessee had claimed entitlement under Section 80HHB in respect of profits on projects. Likewise, it claimed that loss incurred by another Unit, falling within Section 80HHB had to be ignored and that they constitute separate projects. During the relevant period (AY-1989-90 and 1990-91), the assessee had engaged itself in foreign projects in four different places i.e. Saudi Arabia, Libya, Zimbabwe and Malaysia. The AO rejected the claim holding that proviso to section 80HHB (3) restricted the benefit in respect of the reserve created. The AO reduced the amount claimed as deduction by setting off the loss in respect of one section 80HHB unit against the profits from another. The CIT (A) affirmed that decision. The Tribunal by its impugned order held that such setting-off of losses of one unit with another, when both qualified for benefit under section 80HHB, was impermissible in law. The Tribunal's reasoning is as follows: -

> *"24. We have considered the rival submissions. A perusal of the provisions of section 80HHB clearly shows that the deduction is in regard to the profits and gains from the projects outside India. The provisions of section 80HHB clearly specifies whether the gross total income of the assessee being an Indian company includes any profits and gains derived from the business of the execution of a foreign project, the assessee is to be allowed in computing the total income a deduction of such profits and gains of an amount as specified therein. Thus, what is noticed is that the deduction is*

allowable to the assessee in regard to each project. In the circumstances, we are of the view that the deduction u/s 80HHB is to be computed in regard to each project separately. It is further noticed that as per the provisions of Section 80HHB (3) (iii), the convertible foreign exchange is to be brought into India within the period of 6 months from the end of the previous year, referred to in the said section or within the such further period as the competent authority might allow in this behalf. Here, it is noticed that the assessee has made necessary applications for the extension of the said period. In the circumstances, we are of the view that the computation of deduction u/s 80HHB would have to be restored to the file of the AO, who shall re-decide this issue after verifying if the assessee has brought in convertible foreign exchange within such extended period granted by the competent authority. If the assessee has brought in the convertible foreign exchange within the extended period provided, then the same is also liable to be considered for deduction u/s 80HHB otherwise not. In the circumstances, this issue is partly allowed."

The object of enacting Section 80HHB was to extend incentive to export of project business, by treating the income received from it, to the extent provided, deductible from the gross total income. Incentivization of certain kinds of business activities, in this case - promotion of project export and its execution, was sought to be achieved by Parliament through this provision. The conditions and restrictions applicable for such form of incentivization are that:

(1) The aggregate amount of the deductions under Chapter VI cannot, in any case, exceed the gross total income of the assessee (Section 80A);

(2) Where any deduction is required to be made or allowed under any section included Chapter VIA under the heading *"C. - Deductions in respect of certain incomes"* in respect of any income of the nature specified in that section included in the gross total income of the assessee, then, notwithstanding anything contained in that section, for the purpose of computing the deduction under that section, the amount of income of that nature as computed in accordance with the provisions of this Act (before making any deduction under this Chapter) shall alone be deemed to be the amount of income of that nature which is derived or received by the assessee and which is included in his gross total income (Section 80AB);

(3) For claiming benefit under Section 80HHB, the conditions spelt out in section 80 HHB have to be satisfied.

19. Section 80HHB(1) deals with the deductions allowable in computing the gross total income of an assessee, if it "includes" profits and gains of any business of *"the execution of a foreign project"*. The insularity inherent in the execution of "a foreign project" is apparent if one contemplates a situation where the assessee is engaged in the execution or export of foreign projects as its business. If it does so, there is no reason why it cannot derive the

vertical benefit of insulating its losses, and carrying them forward for the next year, from profits derived out of similar activities, undertaken in other projects, or elsewhere. Such construction is in consonance with Parliamentary intent, provided the conditions enacted by Section 80HHB(3) are fulfilled.

20. The Supreme Court had occasion to deal with a somewhat similar situation in *C.I.T. (Central), Madras vs Canara Workshops (P) Ltd,* AIR 1986 SC 1727, where a priority income generating activity's profits (under the then existing Section 80-E, which entitled deduction of a particular kind) was sought to be reduced by the loss suffered in respect of another business activity. The revenue's interpretation of the provision, in support of such a proposition, was rejected; the Court observed as follows:

> *"The assessee in this case carries on two industries, both of which find place in the list in the Fifth Schedule and can, therefore, be described as priority industries. It is urged by the learned Additional Solicitor General, appearing for the Revenue, that on a true application of s. 80E the profit in the industry of automobile ancillaries must be reduced by the loss suffered in the manufacture of alloy steel, and reference has been made to a number of cases to which we shall presently refer. After giving the matter careful consideration we do not find it possible to accept the contention. It seems to us that the object in enacting s. 80E is properly served only by confining the application of the provisions of that section to the profits and gains of a single industry. The deduction of eight per cent is intended to be an index of recognition, that a priority industry has been set up and is functioning efficiently. It was never intended that the merit earned by such industry should be lost or' diminished because of a*

loss suffered by some other industry. It makes no difference that the other industry is also a priority industry. The coexistence of two industries in common ownership was not intended by Parliament to result in the misfortune of one being visited on the other. The legislative intention was to give to the meritorious its full reward. To construe s. 80E to mean that you must determine the net result of all the priority industries and then apply the benefit of the deduction to the figure so obtained will be, in our opinion, to undermine the object of the section. An example will illustrate this. An industry entitled to the benefit of s. 80E could have its profits wholly wiped out on adjustment against a heavy loss suffered by another industry, and thus be totally denied the relief which should have been its due by virtue of its profits. In our opinion, each industry must be considered on its own working only when adjudging its title to the deduction under s. 80E. It cannot be allowed to suffer because it keeps company with some other industry in the hands of the assessee. To determine the benefit under s. 80E on the basis of the net result of all the industries owned by the assessee would be, moreover, to shift the focus from the industry to the assessee. We hold that in the application of s. 80E the profits and gains earned by an industry mentioned in that section cannot be reduced by the loss suffered by any other industry or industries owned by the assessee."

In view of the above, this Court is of opinion that the question of law, framed in respect of the correct interpretation of Section 80 HHB, has to be answered in favour of the assessee, and against the revenue; the Tribunal's decision on this aspect is, consequently, upheld.

21. Lastly, as far as the question regarding correctness of the Tribunal's decision in allowing provision for anticipatory loss (an issue which arose in connected appeals ITA 810/2010 and ITA

813/2010) is concerned, the ITAT by a subsequent order dated 18.3.2011 passed in respect of assessment year 1988-89 (in respect of which a question was pending before this Court in ITA 312/2010) has since rectified its impugned order in exercise of its jurisdiction under section 254(2), and restored the issue for decision after a fresh hearing. In this view, these two appeals (ITA 810 and 813 of 2010), also arising from the impugned order, were disposed off by this Court by separate order with the direction that the revenue may prefer applications under section 254(2) which the Tribunal would be required to consider along with submissions on the issue of allowing provision for anticipatory loss in respect of other assessment years. For the same reasons, the question (of anticipated loss provision) shall be decided afresh, by the Tribunal, provided the Revenue applies for the years under consideration (in ITA-278, 807 & 1578 of 2010) for rectification under Section-254 (2). The order in ITA-312/2010 was rectified on 18.03.2011; so no directions are called for. Liberty is, therefore, granted in the above terms.

22. In light of the aforementioned discussion, Question Nos.1, 2 and 4 are answered in favour of the assessee, and against the revenue; Question 3, on the other hand, is answered in favour of the revenue, and against the assessee. The appeals are disposed off in the above terms.

S. RAVINDRA BHAT, J

SEPTEMBER 11, 2012 **R.V. EASWAR, J**