Vellore Electric Corporation Ltd. Etc vs Commissioner Of Income Tax, Madras on 8 July, 1997

Equivalent citations: AIRONLINE 1997 SC 206, 1997 (6) SCC 705, (1997) 4 SCALE 627, (1997) 227 ITR 557, (1997) 93 TAXMAN 401, (1997) 141 CUR TAX REP 398, (1997) 140 TAXATION 152, (1997) 4 COM LJ 24, (1997) 6 JT 413, (1997) 7 SUPREME 381, (1997) 6 JT 413 (SC)

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Bench: S.C. Agrawal, D.P. Wadhwa

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           CASE NO.:
Appeal (civil)  3333-3334 of 1981

PETITIONER:
VELLORE ELECTRIC CORPORATION LTD. ETC.

RESPONDENT:
COMMISSIONER OF INCOME TAX, MADRAS

DATE OF JUDGMENT: 08/07/1997

BENCH:
S.C. AGRAWAL &  D.P. WADHWA

JUDGMENT:
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JUDGMENT 1997 Supp(1) SCR 586 The Judgment of the Court was delivered by S.C. AGRAWAL, J. These appeals filed by the assessee raise common questions for consideration. Civil Appeals Nos. 3333-3334 of 1981 relating to assessment years 1967-68 and 1968-69 have been filed against the judgment of the Madras High Court dated November 28, 1978 in T.C. No. 116 of 1974 on the basis of certificate of fitness granted by the High Court under Section 261 of the Income Tax Act, 1961 (hereinafter referred to as 'the Income Tax Act"). In these appeals the High Court has answered against the assessee and in favour of the Revenue the following question referred to by the Income Tax Appellate Tribunal (hereinafter referred as 'the Tribunal') :

> "Whether on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that the sums of Rs. 47,055 and Rs. 89,324 transferred to the Development Reserve Account for the Assessment Years 1967-68 and 1968-69 respectively were not to be deducted in arriving at the taxable profits of the assessee-company?"

Civil Appeals Nos. 2613-14 of 1984 have been filed against the judgment of the Madras High Court dated February 6, 1978 on the basis of certificate of fitness granted by the High Court under Section

261 of the Income Tax Act. In these appeals, which relate to assessment years 1969-70 and 1970-71, the High Court has answered against the assessee and in favour of the Revenue the following questions referred by the Tribunal :

> "(1) Whether, on the facts and in the circumstances of the case, the assessee is entitled to deduction of Rs. 55,703 and Rs. 30,104 contributed by it for the 'Contingencies Reserve' for the assessment years 1969-70 an 1970-71 respectively?
>
> (2) Whether, on the facts and in the circumstances of the case, the assessee is entitled to the deduction of Rs. 98,676 and Rs. 18,735 transferred by it to the 'Development Reserve' account and to the 'Tariffs and Dividend Control Reserve' account respectively for the assessment year 1969-70 and Rs. 68,228 transferred by it to the 'Development Reserve' account for the assessment year 1970-71?
>
> (3) Whether, on the facts and in the circumstances of the case and in view of the provisions of the Electricity (Supply) Act, 1948, the assessee is entitled to relief under Section 80-I not only in respect of business income but also in respect of income derived by it from investments in securities?"

The assessee is a public limited company having a licence under the provisions of the Electricity (Supply) Act, 1948 (hereinafter referred to as 'the Electricity Supply Act') to distribute power in the Vellore and Ranipet areas. In view of Section 57 of the Electricity Supply Act read with Sixth Schedule to the said Act, the assessee was required to set apart a part of its profits for reserves known as "Contingencies Reserve", "Development Reserve", and 'Tariffs and Dividend Control Reserve". Under the Sixth Schedule to the Electricity Supply Act the assessee was required to invest the sums appropriated in the 'Contingencies Reserve' in securities authorised under the Indian Trusts Act, 1882, In respect of the assessment years 1967-68 and 1968-69 the assessee claimed deduction of the sums of Rs. 91,715 and Rs. 1,39,781 in respect of the amounts transferred by the assessee to the Contingencies Reserve and Development Reserve. The Income Tax Officer while making the assessment disallowed the said deductions and added the said amounts in the income of the assessee. On appeal, the Appellate Assistant Commissioner allowed certain deductions but did not consider the question of excluding the amounts transferred to the Contingencies Reserve and Development Reserve. On further appeal, the Tribunal disallowed the claim of the assessee with regard to Development Reserve but held that the assessee was entitled to succeed in respect of the claim relating to Contingencies Reserve. The Tribunal referred to the High Court for its opinion the question above mentioned in respect of assessment years 1967-68 and 1968-69 regarding deducibility of the sums transferred to the Development Reserve. On the basis of its earlier judgment in the Vellore Electricity Corporation Ltd, v. Union of India, 109 ITR 454, concerning the assessment year 1966-67 in respect of the same assessee the High Court held that the assessee could not claim deduction in respect of Development Reserve and the question referred was answered against the assessee.

In the assessment year 1969-70 there was appropriation of Rs, 55,703 to the Contingencies Reserve, Rs. 98,676 to the Development Reserve and Rs. 18,735 to the Tariffs and Dividend Control Reserve.

In the assessment year 1970-71 there was appropriation of Rs. 30,104 to the Contingencies Reserve and Rs. 62,288 to the Development Reserve. The assessee also claimed deduction at the rate of 8% under Section 80-I of the Act on Rs. 17,791 and Rs. 14,741 being the interest received by the assessee on Government Securities during the assessment years 1969-70 and 1970-71 in respect of amounts in the Contingencies Reserve which are required to be invested in such securities under the provisions of the Electricity Supply Act. The said claim of the assessee was dismissed by the Income Tax Officer and the Appellate Assistant Commissioner. The Tribunal, on further appeal, allowed the claim of the assessee in respect of appropriation of sums to the Contingencies Reserve, but rejected the claim for deduction of the amounts appropriated to the Development Reserve and Tariffs and Dividend Control Reserve. The Tribunal also allowed the claim of the assessee under Section 80-I of the Act. In respect of the assessment years 1969-70 and 1970-71 the three questions mentioned-above were referred by the Tribunal to the High Court for its opinion. By its judgment dated February 6, 1978, the High Court answered questions Nos. 1 and 2 in favour of the Revenue and against the assessee on the basis of its earlier judgment in Velhre Electric Corporation Ltd. (supra) in respect of assessment year 1966-67. As regards question No. 3 the High Court has held that the interest received on investments of the sums in the Contingencies Reserve could not be considered profit of the company attributable to the business of the assessee which alone could be taken into account for the purpose of Section 80-I of the Act and, therefore, the assessee was not entitled to claim any deduction under Section 80-I. Therefore, the third question was also answered against the assessee.

These appeals broadly involve following two questions :

(i) Is the assessee entitled to claim deduction in respect of sums transferred to the Contingencies Reserve, Development Reserve and Tariffs and Dividend Control Reserve?

(ii) Is the assessee entitled to deduction under Section 80-I on the interest received on the amounts transferred to the Contingencies Reserve which were invested in Government securities?

As indicated earlier, the assessee is a licensee under the Electricity Supply Act for the purpose of distribution of power. Under Section 57 of the Electricity Supply Act the provisions of the Sixth Schedule are deemed to be incorporated in the licence of a licensee, not being a local authority and the licensee is required to comply with the provisions of the said Schedule. The Sixth Schedule contains the financial principles and their application. It makes provisions for creation of the following reserves by the licensee :

(a) Tariffs and Dividend Control Reserve (Paragraph II(1)

(b) Consumers' Rebate Reserve (Paragraph II(4)

(c) Contingencies Reserve (Paragraphs III, VI & V)

(d) Development Reserve (Paragraph VA) In Poona Electric Supply Co. Ltd. v. Commissioner of Income Tax, Bombay City I, (1965) 57 ITR 512, this Court has laid that the amounts credited to the Consumers' Rebate Reserve account did not form part of the real profits of the appellant-company and in order to arrive at the taxable income of the appellant-company from business under Section 10(1) of the Indian Income-tax Act, 1922 the said amounts had to be deducted.

As regards Contingencies Reserve there was difference of opinion among the various High Courts. The High Courts of Madras [Veilore Electric Corporation Ltd. (supra)] and Calcutta [Commissioner of Income Tax, West Bengal v. Sijua (Jharriah) Electric Supply Co. Ltd., (1984) 145 ITR 740] had taken the view that deduction could not be claimed in respect of the amounts appropriated to the Contingencies Reserve. The High Courts of Kerala [Cochin State Power & Light Corporation Ltd. v. Commissioner of Income Tax, Kerala, (1974) 93 ITR 582]; Bombay [Amalgamated Electricity Co. Ltd. v. Commissioner of Income Tax, Bombay City I, (1974) 97 ITR 334] and Patna [Darbhanga Laheriasari Electric Supply Corporation Ltd. v. Commissioner of Income-Tax Bihar, (1979) 117 ITR 516] had taken a contrary view and had held that deduction could be claimed in respect of the amounts appropriated to the Contingencies Reserve, For the purpose of Wealth Tax the Bombay High Court in Commissioner of Wealth-Tax, Bombay v. Bombay Suburban Electric Supply Ltd., (1976) 103 ITR 384, had held that the amount standing to the credit of the Contingencies Reserve is a part of the assets belonging to the assessee and is includible in the net wealth of the assessee and is chargeable to wealth tax. This conflict in the views of the High Courts with regard to taxability of the amounts appropriated to Contingencies Reserve was resolved by this Court in Associated Power Co. Ltd, v. Commissioner of Income Tax, [1996] 7 SCC 221, wherein the decisions of the High Courts of Madras and Calcutta referred-to-above have been approved and the decisions of the High Courts of Kerala and Bombay mentioned above have been overruled. It has been held that Contingencies Reserve is to be created from existing reserves or "from the revenues of the undertaking" which indicates that the monies which have to be put into the Contingencies Reserve reach the electricity company and it is the electricity company which has to invest the sums appropriated to the Contingencies Reserve, It has been pointed out that Contingencies Reserve differs from Consumers' Benefit Reserve since the amount appropriated in the Consumers' Benefit Reserve has to be returned to the consumers and it is as if the electricity company had not received that amount which it is obliged to return and that the position is altogether different in the case of monies standing to the credit of the Contingencies Reserve which are set apart to be utilised by the electricity company for the purposes set out in Paragraph V of the Sixth Schedule to the Electricity Supply Act which are the expenses which the electricity company has to incur and that the reservation is made so that money is always available for meeting these expenses and the supply of electricity is not interrupted. It was held that the monies in the Contingencies Reserve belong to the electricity company. In view of the decision of this Court in Associated Power Co. Ltd. (supra) it must be held that question No. 1 in Civil Appeals Nos. 2613-14 of 1984 relating to Contingencies Reserve has been rightly answered against the assessee and in favour of the Revenue by the High Court.

We may now come to Development Reserve and Tariffs and Dividend Control Reserve, In respect of Development Reserve the following provisions are contained in Paragraph VA of the Sixth Schedule to the Electricity Supply Act ;

"VA. (1) There shall be created a reserve to be called the Development Reserve to which shall be appropriated in respect of each accounting year a sum equal to the amount of income-tax and super-tax calculated at rates applicable during the assessment year for which the accounting year of the licensee is the previous year, on the amount of investment allowances to which the licensee is entitled for the accounting year under Section 32A of the Income Tax Act, 1961 (43 of 1961);

Provided that if in any accounting year, the clear profit excluding the special appropriation to be made under item (va) of clause (c) of sub- paragraph (2) of paragraph XVII together with the accumulations, if any, in the Tariffs and Dividends Control Reserve less the sum calculated as aforesaid falls short of the reasonable return, the sum to be appropriated to the Development Reserve in respect of such accounting year shall be reduced by the amount of the shortfall.

(2) Any sum to be appropriated towards the Development Reserve in respect of any accounting year under sub-paragraph (1), may be appropriated in annual instalments spread over a period not exceeding five years from the commencement of that assessment year.

(3) The Development Reserve shall be available only for investment in the business of electricity supply of the undertaking.

(4) On the purchase of the undertaking, the Development Reserve shall be handed over to the purchaser and maintained as such Development Reserve :

Provided that where the undertaking is purchased by the Board or the State Government, the amount of the Reserve whether such amount is in the form of cash or other assets may be deducted from the price payable to the licensee."

Paragraph VA was inserted by Act 101 of 1956 with effect from April 1, 1957. Prior lo that by Finance Act, 1955 provision for allowances by way of development rebate was incorporated in Section 10(2)(vi)(b) of the Indian Income Tax, 1922 but such rebate was allowable only if an amount equal to 75% of it was debited to the profit and loss account for the relevant previous year and credited to a reserve account to be utilised by the assessee during a period of ten years next following for the purpose of the undertaking except for distribution by way of profits or by way of remittances outside India as profits or the creation of any asset outside India. This obligation did not extend to a case where the assessee was a company, being a licensee within the meaning of the Electricity Supply Act. Therefore, a separate provision was made by amending the Sixth Schedule to the Electricity Supply Act for the creation of a Development Reserve. Development Reserve required lo be created under Paragraph VA of the Sixth Schedule to the Electricity Supply Act is directly related to the Development Rebate being equal to the income tax and the super tax payable on such rebate. The Kerala High Court in Cochin State Power & Light Corporation Ltd. (supra) has made a distinction between Development Reserve and Contingencies Reserve and, while holding that the amounts appropriated to Contingencies Reserve must be deducted, it held that the amounts appropriated to

Development Rebate could not be deducted. The High Court has said :

> "We will now take up the case of development reserve provided under Paragraph V-A of the Sixth Schedule. This, as we have already pointed out, is of the same character as the 75 per cent of the development rebate which the assessee was bound to plough back into the business of the undertaking under the proviso to section 10(2)(vi)(b) of the Income Tax Act, 1922. It cannot be said that the amount is expended by the assessee nor could it be said that it is lost to the assessee to an overriding obligation. The development reserve is still available to the assessee with the only limitation that it is so available only for investment in the business of the electricity supply undertaking. There is no restriction as to the scope of investment of the amount nor reserved in any particular manner. Even the sum to be so appropriated towards the development reserve in respect of any accounting year could not be appropriated in annual instalments spread over for a period not exceeding five years. The benefit of the amount so set apart as reserve is available to the assessee directly. It could be applied by him as he pleases as investment in the business of the electricity supply undertaking." (pp. 591-592) Development Reserve was held to be different from Contingencies Reserve for the reason that while in Contingencies Reserve there is diver-sion of the revenue, there is no such diversion in Development Reserve.

The Madras High Court in Vellore Electric Corporation Ltd. (supra), has disagreed with the view of the Kerala High Court in Cochin State Power & Light Corporation Ltd. (supra) as regards the deductibility of the amounts appropriated to the Contingencies Reserve but has agreed with the view of the Kerala High Court with regard to Development Reserve. According to the Madras High Court, there is no difference between the two revenues and, referring to the decision of the Kerala High Court in this regard, it has been observed :

> "As a matter of fact, the very tests that the learned Judges applied for holding that the development reserve cannot be deducted, will apply to the contingencies reserve also." (p. 462) The view that there is diversion of revenue in Contingencies Reserve has not been accepted by this Court in Associated Power Co. Ltd. (supra).

Shri Harish Salve, the learned senior counsel appearing for the assessee, has urged that under the Sixth Schedule there is difference between Development Reserve under Paragraph VA(1) and Contingencies Reserve under Paragraphs III, IV and V. The learned counsel has laid stress on the difference in the language used in sub-para (2) of Paragraph V relating to Contingencies Reserve and sub-para (4) of Paragraph VA relating to Development Reserve, Sub-para (2) of Paragraph V and Sub-para (4) of Paragraph VA provide as follows :

> "V(2). On the purchase of the undertaking, the Contingencies Reserve, after deduction of the amounts drawn under sub-paragraph (1), shall be handed over to the purchaser and maintained as such Contingencies Reserves :

> Provided that where the undertaking is purchased by the Board or the State Government, the amount of the Reserve computed as above shall, after further deduction of the amount of compensation, if any, payable to the employees of the outgoing licensee under any law for the time being in force, be handed over to the Board or the State Government, as the case may be.
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> VA(4). On the purchase of the undertaking the Development Reserve shall be handed over to the purchaser and maintained as such Development Reserve :
>
> Provided that where the undertaking is purchased by the Board or the State Government, the amount of the Reserve whether such amount is in the form of cash or other assets may be deducted from the price payable to the licensee."

A perusal of the said provisions would indicate that the main part of sub- para (2) of Paragraph V and sub-para (4) of Paragraph VA are practically the same. There is difference in the Proviso to the said provisions. Under the Proviso to sub-para (2) of Paragraph V where the undertaking is purchased by the State Electricity Board or the State Government the amount of the Contingencies Reserve after further deduction of the amount of compensation, if any, payable to the employees of the outgoing licensee under any law for the time being in force, has to be handed over to the Electricity Board or the State Government as the case may be. Under the Proviso to sub-para (4) of Paragraph VA where the undertaking is purchased by the State Electricity Board or the State Government the amount of Development Reserve has to be deducted from the price payable to the licensee. This difference in the two provisions does not, in our opinion, mean that the amounts appropriated to Development Reserve were not part of the real profit of the Electricity Company. Like Contingencies Reserve, Development Reserve also belonged to the Electricity Company and it had the use of it. The Contingencies Reserve is meant to be utilised by the Electricity Company to meet the expenses or recoup loss of profits arising out of accidents, strikes or other circumstances which the Electricity Company could not have promoted or to meet the expenses on replacement or renewal of plant or works or for payment of compensation required by law for which no other provision has been made. Development Reserve is meant for investment in the business of electricity supply of the undertaking. On the purchase of the undertaking Contingencies Reserve as well as Development Reserve have to be handed over to the purchaser and have to be maintained as Contingencies Reserve and Development Reserve, as the case may be, in view of the main part of sub-para (2) of the Paragraph V and sub-para (4) of Paragraph VA. Under the Proviso to sub-para (2) of Paragraph V where the undertaking is purchased by the Electricity Board or the State Government the amount of Contingencies Reserve, after deduction of the amount of compensation, if any, payable to the employees of the outgoing licensee, is to be handed over to the Electricity Board or the State Government as the case may be. Under sub-para (4) of Paragraph VA the amount of Development Reserve, instead of being handed over to the Electricity Board or the State Government, can be deducted from the price payable to the licensee. Both the provisions achieve the same result, viz., the Reserve being available to the State Electricity Board or the State Government. The difference in the language in the Provisos in sub-para (2) of Paragraph V and sub-para (4) of Paragraph VA may be due to the fact that the liability for the payment of compensation payable to the employees of the outgoing licensee would be of the licensee and the said liability has to be met

out of the Contingencies Reserve in view of Paragraph V(1)(c) of the Sixth Schedule and the amount of Contingencies Reserve is to be handed over after deducting the amount of compensation so payable by the licensee.

There is, therefore, no difference between Development Reserve and Contingencies Reserve and the High Court, in the impugned judgment, has rightly held that the amount appropriated towards Development Reserve could not be deducted.

Provisions regarding Tariffs and Dividend Control Reserve are contained in sub-paras (1), (2) and (3) of Paragraph II of the Sixth Schedule. The said provisions are practically in the same terms as those contained in Paragraph VA relating to Development Reserve. Sub-para (2) of Paragraph II requires that the Tariffs and Dividend Control Reserve shall be available for disposal by the licensee only to the extent by which the clear profit is less than the reasonable return in any year of account. Under sub-para (3) of Paragraph II on the purchase of the undertaking under the terms of license any balance remaining in the Tariffs and Dividend Control Reserve has to be handed over to the purchaser and has to be maintained as such Tariffs and Dividend Control Reserve and where the undertaking is purchased by the State Electricity Board or the State Government the amount of the Tariffs and Dividend Control Reserve may be deducted from the price payable to the licensee. The reasons given for holding that the amounts appropriated to Development Reserve could not be deducted are equally applicable to Tariffs and Dividend Control Reserve and it must, therefore, be held that the amounts appropriated to the Tariffs and Dividend Control Reserve could not be deducted.

It must, therefore, be held that the question referred in Civil Appeals Nos. 3333-3334 of 1981 and question No. 2 referred in Civil Appeals Nos. 2613-14 of 1984 have been rightly answered against the assessee and in favour of the Revenue by the High Court in the impugned judgments.

We may now come to question No. 3 in Civil Appeals Nos. 2613-14 of 1984 which relates to relief claimed by the assessee under Section 80-I of the Act in respect of income earned by way of interest on investment in securities of the amounts appropriated to the Contingencies Reserve. At the relevant time Section 80-I read as under :

> "Section 80-I. Deduction in respect of profits and gains from priority industries in the case of certain companies. - (1) In the case of a company to which the section applies, where the gross total income includes any profits and gains attributable to any priority industry, there shall be allowed, in accordance with and subject to the provisions of this section, a deduction from such profits and gains of an amount equal to eight per cent thereof, in computing the total income of the company.
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> (2) This section applies to a domestic company, save in a case where such company is a company which is referred to in section 108 and has a gross total income of fifty thousand rupees or less.

> (3) Where a company to which this section applies is entitled also to the deduction under section 80H, the deduction under sub-section (1) of this section shall be allowed with reference to the amount of the profits and gains attributable to the priority industry or industries as reduced by the deduction under section 80H in relation to such profits and gains."

Prior to the enactment of Section 80-I a similar provision was contained in Section 80E which was applicable to certain specific industries mentioned therein, Sub-section (1) of Section 80E provided as under :

> "Section 80E. Deduction in respect of profits and gains from specified industries in the case of certain companies. - (1) In the case of a company to which this section applies, where the total income (as computed in accordance with the other provisions of this Act) includes any profits and gains attributable to the business of generation or distribution of electricity or any other form of power or of construction, manufacture or production of any one or more of the articles or things specified in the list in the Fifth Schedule, there shall be allowed a deduction from such profits and gains of an amount equal to eight per cent, thereof, in computing the total income of the company.
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> (2) This section applied to -(a) an Indian company; or
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> (b) any other company which has made the prescribed arrangements for the declaration and payment of dividends (including dividends on preference shares) within India but does not apply to any Indian company referred to in clause (a), or to any other company referred to in clause (b), if such Indian or other company is a company referred to in Section 108 and its total income as computed before applying the provisions of sub-section (1) does not exceed twenty-five thousand rupees."

The said provision came up for consideration before this Court in Cambay Electric Supply Industrial Co. Ltd. v. The Commissioner of Income Tax, Gujarat-II, Ahmedabad, [1978] 2 SCC 644. In that case, while construing the expression "profits and gains attributable to the business of in Section 80E, this Court said :

> "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 Section 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."

(pp. 654, 655) Shri Harish Salve has submitted that the said judgment in Cambay Electric Supply Industrial Co. Ltd. (supra) was not available to the High Court at the time when question No. 3 was answered by the impugned judgment in Civil Appeal Nos, 2613-14 of 1984 since the case of Cambay Electric Supply Industrial Co. Ltd. (supra) was decided on April 11, 1978 while the impugned judgment of the High Court was delivered on February 2, 1978. The submission is that in view of the interpretation placed by this Court on the words 'attributable to' in Cambay Electric Supply Industrial Co. Ltd. (supra), the income by way of interest on the amounts lying in Contingencies Reserve that were invested in securities have to be treated as profits and gains attributable to the business of the assessee-company in generating electricity as a licensee under the Electricity Supply Act. In this context, Shri Salve has placed reliance on sub-para (2) of Paragraph IV of the Sixth Schedule to the Electricity Supply Act which reads as follows : "IV(2). The suras appropriated to the Contingencies Reserve shall be invested in securities authorised under the Indian Trusts Act, 1882 (92 of 1882) and such investment shall be made within a period of six months of the close of the year of account in which such appropriation is made."

The submission is that since the assessee, as a licensee, was required to appropriate certain amounts in the Contingencies Reserve and to invest the same as securities authorised under the Indian Trusts Act, 1882, the income by way of such investments as securities has to be treated as profits and gains attributable to the business of the assessee to generate electricity as licensee under the Electricity Supply Act.

Shri K.N. Shukla, the learned senior counsel appearing for the Revenue, has, however, submitted that income derived by way of interest from investment securities cannot be regarded as profits and gains attributable to the business of generating electricity carried on by the assessee. Shri Shukla has placed reliance on the decisions of various High Courts. (Indian Aluminium Co, Ltd. v. Commissioner of Income-Tax, West Bengal-II, 122 ITR 660 (Calcutta); Commissioner of Income-Tax, Kerala-I, Emakulam v. Cochin Refineries Ltd., 154 ITR 344 (Kerala); Commissioner of Income-Tax, Tamil Nadu-V v. Universal Radiators P. Ltd., 128 ITR 531 (Madras); Commissioner of Income-Tax v. Kirloskar Oil Engines Ltd., 157 ITR 762 (Bombay); and English Electric Co. of India Ltd. v. Commissioner of Income-Tax, 168 ITR 513 (Madras).

In Indian Aluminium Co. Ltd. v. Commissioner of Income-Tax West Bengal-II (supra) the assessee was carrying on business as manufacturer of aluminium. Income by way of interest had accrued from the surplus funds of the assessee that had been invested for short periods. It was held by the Calcutta High Court that no part of the interest accruing from company investments of surplus funds can be said to be attributable to the priority industry of the assessee and that such interest had arisen by reason of the surplus fund being not employed in the priority industry and that such

temporary investment had not been shown to have any connection whatsoever direct or indirect with the priority industry of the assessee.

In Commissioner of Income-Tax, Tamil Nadu-V v. Universal Radiators P. Ltd. (supra) the assessee had surplus funds which it had invested in the bank in fixed deposit and thereafter when the assessee wanted money from the bank on the security of the said fixed deposit, amounts were lent by the bank. After observing that the Court was concerned with the deposit having nexus with the priority industry at the stage at which the amounts were deposited in the bank and started earning interest, the Madras High Court held that, considering the question of the interest income at the stage at which the deposit was made, the use of the receipt as security docs not make the income that of the priority industry. The High Court has referred to the impugned judgment (which had since been reported in 119 ITR 523) and after taking note of the decision of this Court in Cambay Electric Supply Industrial Co. Ltd, (supra), the High Court has said :

> "In the context of the pronouncement of the Supreme Court, the view taken by this Court that the profits and gains must arise from the specific activities or business of generation of electricity may have to be reconsidered. As 'attributable to' is wider than 'derived from, the relief is not confined only to the profits of the priority industry strictly so called. It would have a wider ambit. However, the conclusion arrived at in the case is unexceptionable because the character of the interest is different from the character of the income attributable to the priority industry." (128 ITR 539, 540) In Commissioner of Income-Tax, Kerala-I, Emakulam v. Cochin Refineries Ltd. (supra) the assessee had derived interest on bank deposits. The said deposits were of amounts meant for the purpose of re-payment Of loans which were so deposited as the loans were not due for re-payment. Such deposits were for short duration and were subsequently utilised for re-payment of loans. Deduction was claimed under Section 80-I in respect of interest received from these deposits. The Kerala High Court held that the amounts of interest were receipts from other sources and not profits and gains attributable to the business of the assessee as a priority industry and the assessee was not entitled to deduction under Section 80-I in respect of such amounts. The Court has expressed its agreement with the impugned judgment and has observed that the decision of this Court in Cambay Electric Supply Industrial Co. Ltd. (supra) did not support the contention of the assessee to the contrary. It was held that the words "profits and gains" in the expression "profits and gains attributable to any priority industry" means only the business income and not any other income.

Commissioner of Income-Tax v. Kirloskar Oil Engines Ltd, (supra) related to profits earned by the assessee from sale of dry fruits imported under Import Licences granted under the Export Promotion Scheme. The assessee was engaged in the business of manufacture and export of oil engines. It was held that the said profits did not qualify for relief under Section 80-I of the Act because the same could not be said to be profits attributable to the priority industry, namely, manufacture and export of oil engines. The Bombay High Court has said that it is not enough that there should be a traceable relationship between the profits earned and the priority industry and

that the profits must be more closely linked to the priority industry for it to be held that they were attributable to it. It was observed that profits realised upon the sale of the import entitlements are so closely and directly linked as to be attributable to the priority industry but when the assessee has utilised the import entitlements, imported goods and sold them, the profits so earned are too remotely linked to be attributable to the priority industry.

In English Electric Co. of India Ltd. v. Commissioner of Income-Tax (supra) the assessee had received interest from supplies of raw materials, the State Electricity Board, banks as well as on security deposits with other agencies. The Madras High Court, while following its earlier decision in Universal Radiators P. Ltd. (supra) and the decision of this Court in Cambay Electric Supply Industrial Co. Ltd. (supra), has held that in so far as the interest received from a bank deposits was concerned, the same could not be attributable to the priority industry itself but as regards interest earned on other deposits, the High Court held that they were in the nature of security deposits for the purpose of contracts by the assessee-company and in case of interest received from supply of raw materials, the same was received because the raw materials were not supplied at all and the advance receipts were returned with interest which had a direct nexus with the business of the priority industry and that when the company had to keep security deposits such deposits were necessary for the purpose of its business and any such interest obtained from such deposits would be clearly attributable to priority industry. This decision indicates that in a case where the security deposit is necessary for the purpose of business of the assessee, then the interest obtained therefrom can be said to be attributable to the priority industry.

To the same effect is the decision of the Calcutta High Court in Commissioner of Income Tax v. Dunlop India Ltd., 197 ITR 34 (Calcutta). In this case deposits were made by the assessee with the Excise department for obtaining manufacturing facilities under the Central Excise laws and with the electricity boards in West Bengal and Tamil Nadu for the purpose of obtaining industrial power connections. It was held that these deposits made were incidental to and for the purpose of carrying on the business of priority industry and the interest receipts earned from these securities had to be treated as part of the profits and gains attributable to a priority industry under Section 80-I of the Act.

The position that emerges from these decisions is that profits and gains can be said to be attributable to the priority industry under Section 80-I if there is a direct and proximate connection between the profits and gains and the business of the priority industry. In this context, reference may be made to the recent decision in Indian Leather Corporation P. Ltd. v. Commissioner of Income Tax, (C.A. No. 292 of 1982 decided on April .30,1997) this Court, while construing the words "income attributable to any of the aforesaid activities" in Section 104(4) of the Act, has said :

> "In order that income can be said to be attributable to manufacture or processing of goods for the purpose of Explanation to Section 104(4) of the Act the earning of the income must be directly connected with manufacture or processing of goods."

In the present case, the assessee is carrying on business of generating electricity as a licensee under the Electricity Supply Act. Under Section 57 of the Electricity Supply Act the provisions of the Sixth

Schedule shall be deemed to be incorporated in the license of every licensee. Under Paragraph III of the Sixth Schedule, the licensee is obliged to create from existing reserves or from the revenues of the undertaking a reserve called 'Contingencies Reserve' and under sub-para (2) of Paragraph IV the licensee is obliged to invest the sums appropriated to the Contingencies Reserve in securities authorised under the Indian Trusts Act, 1882. The requirement to create the Contingencies Reserve is a part of the obligation of the assessee as a licensee to carry on its business of generating electricity and it is also part of the obligation of the assessee as a licensee that the sums appropriated to the Contingencies Reserve arc invested in securities authorised under the Indian Trusts Act, 1882. In Cambay Electric Supply Industrial Co. Ltd. (supra) this Court has said :

> "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.'' This would mean that it is not necessary that the income should have been earned from the actual conduct of the business of generation and distribution of electricity. What is required is that the activity from which the income is earned must have a direct and proximate connection with the priority industry of generation and distribution of electricity. The creation of the Contingencies Reserve and the investment of the sums appropriated to the said Reserve in security authorised under the Indian Trusts Act, 1882, being a condition statutorily incorporated in the license granted to the assessee under the Electricity Supply Act, is incidental to the carrying on of the business of generation and distribution of electricity by the assessee. There is thus a direct and proximate connection between the carrying on the business of generation and distribution of electricity by the assessee as a licensee under the Electricity Supply Act and the income derived by way of interest from the investments in securities of the sums appropriated to the Contingencies Reserve as required under the provisions of the Sixth Schedule to the Electricity Supply Act which is one of the conditions of license on the basis of which the assessee can carry on its business of generating and distributing electricity. We are, therefore, of the view that the income earned by way of interest on the sums appropriated to the Contingencies Reserve which have been invested in securities can be said to be profits and gains attributable to the business of the assessee for the purpose of Section 80-I of the Act. Question No. 3 in Civil Appeals Nos, 2613-14 of 1984 is, therefore, answered in the affirmative, i.e., in favour of the assessee and against the Revenue.
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> In the result, Civil Appeals Nos, 3333-3334 of 1981 are dismissed and Civil Appeal Nos. 2613-14 of 1984 are partly allowed to the extent that question No. 3 is answered in the affirmative, in favour of the assessee and against the Revenue and the impugned judgment of the High Court is reversed to this extent. There is no order as to costs.
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> C.A. Nos. 3333-3334/81 dismissed.
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> C.A. Nos. 2613-14/84 allowed.