2020 INSC 544

REPORTABLE

IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 5105 OF 2009

NATIONAL CO-OPERATIVE DEVELOPMENT CORPORATION **…Appellant**

Versus

COMMISSIONER OF INCOME TAX, DELHI-V **…Respondent**

With
C.A.No.5106/2009 and
C.A.No.5107/2009

J U D G M E N T

SANJAY KISHAN KAUL, J.

1. Which pocket of the Government should be enriched has taken forty-four (44) years to decide – a classic case of what ought not to be!

The factual matrix:

2. The appellant-Corporation, National Co-operative Development Corporation, was established under the National Cooperative

Development Corporation Act, 1962 (hereinafter referred to as the 'NCDC Act'). The Preamble of the NCDC Act reads as under:

> "An Act to provide for the incorporation and regulation of a Corporation for the purpose of planning and promoting programmes for the production, processing, marketing, storage, export and import of agricultural produce, foodstuffs, industrial goods, livestock, certain other commodities and services on cooperative principles and for matters connected therewith or incidental thereto."

3. The functions of the appellant-Corporation are set out in Section 9 of the NCDC Act, which is, *inter alia*, to advance loans or grant subsidies to State Governments for financing cooperative societies; provide loans and grants directly to the national level cooperative societies, as also to the State level cooperative societies, the latter on the guarantee of State Governments. The funding process for the appellant-Corporation is set out in Section 12 of the NCDC Act, by way of grants and loans received from the Central Government. The appellant-Corporation is required to maintain a fund called the National Cooperative Development Fund (for short 'the Fund') which is, *inter alia*, credited with all monies received by it by way of grants and loans from the Central Government, as well as sums of money as may from time to time be realised out of repayment of loans made from the Fund or from interest on loans or dividends or other

realisations on investments made from the Fund. Section 13 mandates maintenance of a Fund and the same reads as under:

> "13. Corporation to maintain fund.— (1) The Corporation shall maintain a fund called the National Cooperative Development Fund (hereinafter referred to as the Fund) to which shall be credited—
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> (a) all moneys and other securities transferred to it under clause (a) of sub-section (2) of section 24;
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> (b) the grants and other sums of money by way of loans paid to the Corporation by the Central Government under section 12;
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> (bb) all moneys received under section 12B;
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> (bbb) all moneys received for services rendered;
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> (ba) all moneys borrowed under section 12A;
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> (c) such additional grants, if any, as the Central Government may make to the Corporation for the purposes of this Act; and
>
> (d) such sums of money as may, from time to time, be realised out of repayment of loans made from the Fund or from interest on loans or dividends or other realisations on investments made from the Fund.
>
> (2) The moneys in the Fund shall be applied for—
> (a) advancing loans and granting subsidies to State Governments on such terms and conditions as the Corporation may deem fit for the purpose of enabling State Governments to subscribe to the share capital of co-operative societies or for otherwise financing co-operative societies;
>
> (b) meeting the pay and allowances of the managing director, the officers and other employees of the Corporation and other

administrative expenses of the Corporation; and

(c) carrying out the purposes of this Act."

(emphasis supplied)

In furtherance of this, as and when surplus funds accumulated, the appellant-Corporation invested the idle funds in fixed deposits from time to time, which generated income. It may also be noted that income by way of interest on debentures and loans advanced to the State Governments/Apex Cooperative Institutions are credited to this account.

4. Even though the appellant-Corporation is an intermediary or "pass through" entity, it is a distinct juridical entity. Its taxation status is as follows:

i. Insofar as funds are received from the Central Government, these are treated as capital receipts, and hence are not chargeable to tax. There is no dispute about this.

ii. With respect to the interest component, it is treated as taxable income and is logically taxed as "business income."

The issue which has arisen for consideration is whether the component of interest income earned on the funds received under Section 13(1), and disbursed by way of "grants" to national or state level co-operative

societies, is eligible for deduction for determining the “taxable income” of the appellant-Corporation. This was, as stated herein, contrary to the earlier accounting practice and arose for the first time for the assessment year 1976-77. Accordingly, the factual matrix pertaining to this aforementioned assessment year has been taken on record.

5. The aforesaid endeavour of the appellant-Corporation did not succeed before the Assessing Officer (for short ‘AO’). The AO opined that the non-refundable grants were in the nature of capital expense and not a revenue expense and, thus, disallowed the same as a deduction. What weighed with the AO was also the fact that the grants received from the Central Government were in the nature of a capital receipt exempt from tax. The AO noted that no deduction as sought for has been claimed in the previous assessment years. Of course, subsequently, the stand of the appellant-Corporation, as the assessee, was that the same was a mistake and they could not be bound by the same for the subsequent years. This round went to the Revenue Department.

6. An appeal was preferred before the Commissioner of Income Tax (Appeals), New Delhi (for short ‘CIT(A)’), which in terms of the order

dated 22.8.1980 opined that the grants made by the appellant-Corporation undisputedly fall within its authorised activities, which are interlinked and interconnected with its main business of advancing loans on interest to State Governments and cooperative societies. These grants were intended to be utilised for various projects which were admittedly of capital nature and resulted in the acquisition of capital assets, but not by the appellant-Corporation itself. Thus, a conclusion was reached that, in terms of Section 37 of the Income Tax Act, 1961 (hereinafter referred to as the 'IT Act') as it stood for the relevant assessment year, any expenditure (except of the prohibited type) laid out or expended wholly and exclusively for the purpose of the business was allowable as a deduction while computing business income. The CIT(A), thus, found that the approach adopted by the AO was fallacious as the functions and activities of the appellant-Corporation included giving loans and grants which, in fact, was the very purpose for which it had been set up. The appellant-Corporation was, thus, held entitled to the deduction of Rs. 19,35,950/-. The net deduction, however, allowed was limited to Rs. 13,66,187/- on account of refund of the grants to the extent of Rs. 5,69,763/-, which had remained unutilised. The second round, thus, went

to the appellant-Corporation.

7. It was now the turn of the Revenue Department to prefer an appeal before the Income Tax Appellate Tribunal (for short 'ITAT'), Delhi Bench, which, however, accepted the view taken by the AO and did not agree with the approach of the CIT(A), setting aside the order of the CIT(A). The rationale for doing so was slightly different. It held that the grants, additional grants and other sums received by the appellant-Corporation from the Central Government went to a single fund and were not treated as its income and, thus, the disbursements made from the same could not be treated as revenue expenses. The disbursement of monies to State Governments and cooperative societies were held to be a pure and simple application of the Fund under Section 13(2) of the NCDC Act and could not be an expenditure in the nature of revenue. Round three, thus, went to the Revenue Department.

8. The fourth round was before the Delhi High Court where on a reference made under Section 256(1) of the IT Act, the High Court accepted the question of law to be answered as under:

> "Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was justified on facts and in law in holding that amount of Rs.19,35,950/- being grants disbursed by

> the assessee-applicant to various State Governments during the financial year 1975-76 relevant to asstt. year 1976-77 was not in the nature of Revenue expenditure, hence not allowable in computing the total income of the assessee for the asstt. year under reference."

9. It appears that the aforesaid practice of claiming allowable deductions was sought to be followed in the subsequent assessment years and the High Court by the common impugned judgment dated 24.11.2006 answered the reference qua the assessment years 1976-77 and 1981-82.

10. Now turning to the High Court order, this fourth round again went in favour of the Revenue Department answering the reference accordingly. In terms of the reasoning of the High Court, it was a mixed bag for the two sides. The argument of the Revenue Department that such interest income of the appellant-Corporation would fall within the category of income from other sources under Section 56 of the IT Act, for which allowable deductions are enumerated under Section 57 of the IT Act was, however, repelled. The Revenue Department further sought to argue that the advances were in the form of application of income rather than expenditure of income. It also argued that the loans disbursed were

liable to be refunded in terms of the agreement under which they were advanced, making them ineligible to be treated as expenditure. Moreover, once the interest income was received, it merged into Section 13 Fund of the appellant-Corporation and lost its character as business income.

11. The High Court opined that since the business of the appellant-Corporation was to receive funds and to then advance them as loans or grants, the interest income earned which was so applied would also fall under the head ‘D’ of Section 14 of Chapter IV of the IT Act under the head of ‘profits and gains of business or profession’ being a part of its normal business activity. The High Court delved into the scheme of the NCDC Act and in view of Section 13, which provided for the creation of a fund, being the common pool where all accretions get amalgamated, including from interest on loans and dividends and interest earned on FDRs. It was held that the monies which were advanced from the Fund cannot be distinctly identified as forming part of the interest income. The other aspect the High Court opined on was that in order to claim deduction as a revenue expenditure, the appellant-Corporation has to first establish that it incurred an expenditure. The advancement of loans to the

State Governments and cooperative societies could not be claimed as expenditure as the same does not leave the hands of the appellant-Corporation irretrievably. It is not necessary for us to delve further into this issue as that was not the question framed to be answered.

12. We are now faced with Civil Appeals in relation to different assessment years, which arise from the common judgment dated 24.11.2006 and the common order dated 12.7.2007, which had in turn relied on the 24.11.2006 judgment. The particulars are in a tabulated form as under:

Civil Appeal Number	**Assessment Year(s)**	**Deduction Sought**	**Arising out of**
5105/2009	1976-77 1981-82	Rs. 19,35,950 Rs. 1,96,17,920	Common order dated 24.11.2006
5106/2009	1982-83	Rs. 1,26,90,860	Order dated 12.7.2007 decided in terms of order dated 24.11.2006
5107/2009	1983-84	Rs. 1,39,38,943	Order dated 12.7.2007 decided in terms of order dated 24.11.2006

13. It is, thus, left to this Court as usual to give the final knock-out punch, being the fifth round of adjudicatory process on this issue itself!

14. We may also notice a fact that originally the Special Leave Petition was dismissed leaving it to the appellant-Corporation to get its petition revived in case permission was granted by the High Powered Committee. This was in view of the fact that the Committee existed then to settle inter-governmental disputes, but was subsequently disbanded. The record shows that a meeting of the Committee was held on 14.8.2007 and it was felt that the question regarding the nature of grants disbursed by the appellant-Corporation needed adjudication by the Court, though the Committee did not itself settle the issue. The representative of the appellant-Corporation before the Committee faulted the view taken by the High Court *inter alia* on the ground that expenditure as monies advanced as loans do not go out of the hands of the Corporation irretrievably was a finding, which was not based on the facts of the case as the issue pertained only to the grants and not to the loans. The grants were disbursed in accordance with the provisions of Section 9 of the NCDC Act and, thus, monies advanced as grants never came back to the appellant and were in the nature of expenditure of the appellant-Corporation. The Committee was of the view that the grants disbursed by the appellant-Corporation were not in the nature of loans and were

exclusively for business of the Corporation and should have been treated as revenue expenditure.

Contentions of the parties:

15. On behalf of the appellant-Corporation, Mr. Rajat Navet contended that the High Court has fallen into an error in discussing the issue as if it was one of loans as opposed to grants, which was the subject matter of the reference. Thus, what was contended was that there was some confusion in the impugned order vis-à-vis this aspect of loans and grants. It was, thus, submitted on behalf of the appellant-Corporation as under:

i. Any grants disbursed (to National or State Governments, for further disbursal to co-operative societies) out of the 'Interest Income', which is admittedly taxed as "business income" by the Revenue Department, is allowable as a revenue expenditure under Section 37(1) of the IT Act, 1961.

ii. The error and anomaly in the judgment of the High Court, is that in para 22, it has treated "grants" and "loans" at par, or as identical in nature. There is a distinction between "grants" and "loans", since the monies advanced as 'loans' come back into the coffers of the appellant-Corporation; however, with respect to

“grants” or “subsidies”, there is an irretrievable outgo from the coffers of the appellant-Corporation. This distinction has not been examined by the High Court.

The claim of the appellant-Corporation is restricted only with respect to “grants,” and not “loans.”

iii. The High Court erred in holding that as the taxable interest/income or the revenue stream of income gets amalgamated in the common pool of the Fund under Section 13(1) of the NCDC Act, along with the funds received from the Central Government, it loses its revenue character, and becomes a capital receipt.

iv. The High Court erred in holding that it cannot be identified as to which component of the funds has been advanced by way of “grants”. It is not ascertainable as to whether it is from the income earned, or capital receipts. The appellant-Corporation submitted that merely because a common Fund is maintained by it in terms of Section 13 of the NCDC Act, the interest income earned/received by the appellant-Corporation cannot lose its character of “business income” and gets transformed into a capital receipt. If this contention is accepted, then even the interest income will not be

liable to tax under profits and gains of business, and must be treated as a capital receipt.

v. Since the accounts of the appellant-Corporation are duly audited, it would be able to demonstrate the nexus of the income receipts to the amounts disbursed by way of grants. The claim of deduction is restricted to the outright grants made from the revenue receipts, which are subjected to tax in the normal course of business. The CIT(A) has rightly allowed only those grants, which were in fact disbursed out of the taxable interest income of the appellant as expenditure.

vi. Since the grants are given in the normal course of the appellant-Corporation's business, those grants which are from the interest income, and assessed as "business income," should be allowed as deductions from the taxable income of the appellant-Corporation. The requisite conditions for being allowed as a deduction under Section 37(1) of the IT Act stand fulfilled since:

a. the expenditure has been incurred wholly and exclusively for the purpose of business being carried out by the assessee;

b. it has been expended during the accounting year in

question.

c. it is not on any personal account of the assessee;

d. it is not in the nature of capital expenditure.

vii. The expenditure incurred by the appellant-Corporation cannot be capital expenditure as neither any enduring advantage or benefit has accrued to it, nor had any asset come into existence which belonged to or was owned by the appellant-Corporation.

16. A reference was made to the judgment of this Court in ***Commissioner of Income Tax, Bombay v. Associated Cements Companies Ltd.,***[1] which in turn cited with approval the dictum of Viscount Cave. L.C. in ***Atherton v. British Insulated and Helsby Cables Ltd.***[2] as under:

> "But when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade. I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital."

It was opined that there may be cases where expenditure, even if incurred for obtaining an advantage of enduring benefit, may, nonetheless, be on

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11988 (Supp) SCC 378
2(1924) 10 Tax Cases 155, 192-83: (1926) AC 205 (HL)

the revenue account and the test of enduring benefit may break down, but what is material to consider is the nature of the advantage in a commercial sense and it is only where the advantage is in the capital field, that the expenditure would be disallowable on an application of this test. If the advantage consists merely in facilitating the assessee's trading operations or enabling the management and conduct of the assessee's business to be carried on more effectively or more profitably while leaving the fixed capital untouched, the expenditure would be on the revenue account, even though the advantage may endure for an indefinite future.

17. A reference was also made to the judgment in ***M/s. Empire Jute Co. Ltd. v. Commissioner of Income Tax***[3] to contend that what may be a capital receipt in the hands of the payee, may be a revenue expenditure in relation to the payer. Para 5 of the said judgment read as under:

> "5. In the first place it is not a universally true proposition that what may be a capital receipt in the hands of the payee must necessarily be capital expenditure in relation to the payer. The fact that a certain payment constitutes income or capital receipt in the hands of the recipient is not material in determining whether the payment is revenue or capital disbursement qua the payer. It was felicitously pointed out by Macnaghten, J. in *Race Course Betting*

3(1980) 4 SCC 25

Control Board v. Wild that a "payment may be a revenue payment from the point of view of the payer and a capital payment from the point of view of the receiver and vice versa. Therefore, the decision in *Maheshwari Devi Jute Mills* case cannot be regarded as an authority for the proposition that payment made by an assessee for purchase of loom hours would be capital expenditure. Whether it is capital expenditure would have to be determined having regard to the nature of the transaction and other relevant factors."

18. On the other hand, Mr. Arijit Prasad, learned senior counsel, on behalf of the Revenue Department, submitted as under:

i. Since the interest income received has merged with the monies in the common Fund, it loses its revenue character, and becomes a capital receipt.

ii. The grants given to State Governments and national co-operatives are not in the course of trade business of the appellant-Corporation, but are a mere application of income.[4]

iii. The giving of grants was an application of income hence it was not an expenditure. Even if it was to be considered as a case of expenditure, it would, at best, be in the nature of capital expenditure.

iv. The direct nexus of monies given as outright grants from the

4Commissioner of Income Tax, Bombay v. Shri Sitaldas Tirathdas, (1961) 2 SCR 634

taxable interest income, cannot be distinctly identified in the common Fund.

19. The Revenue Department sought to revive the debate on the issue repelled by the High Court, i.e., that the income should be treated as income from other sources under Section 56 of the IT Act and not under Section 28 of the IT Act. The exemption, if any, thus, would be under Section 57 and not under Section 37 of the IT Act.

Conclusion:

20. We have given considerable thought to the rival contentions of learned counsels for the parties even though the dispute is really in a narrow compass.

21. The first aspect which we would advert to is whether interest on loans or dividends would fall under the head of 'Income from other sources' under Section 56 of the IT Act or would it amount to income from 'Profits and gains of business or profession' under head 'D' of Section 14 of the IT Act. In terms of Section 28 of the IT Act such profits and gains of any business or profession under the head 'D' of Section 14 of the IT Act would be chargeable to income tax if the income is relatable to profits and gains of business or profession carried out by the assessee

at any time during the previous year [Clause (i) of Section 28 of the IT Act]. Section 56 of the IT Act is in the nature of a residuary clause, i.e., if the income of every kind which is not to be excluded from total income under the IT Act would be chargeable under this head if it is not chargeable under Section 14 heads 'A' to 'E'.

22. The aforesaid aspect did not form a part of the rationale of the view taken by the AO, but the CIT(A) opined that the grants made by the appellant-Corporation undisputedly fall within its authorised business activities and, thus, even the advancing of grants from the interest income would be a revenue expense as it had not resulted in acquisition of capital assets by the appellant-Corporation and, thus, would be adjustable under Section 37(1) of the IT Act. The ITAT, while reversing the order of the CIT(A), does not deal with this aspect but the impugned judgment of the High Court, once again, adverted to this aspect and came to the conclusion that the interest income would fall under head 'D' of Section 14 of the IT Act and would not fall under the head of 'income from other sources' under Section 56 of the IT Act.

23. We are in agreement with this view taken by the High Court, as the only business of the appellant-Corporation is to receive funds and then to

advance them as loans or grants. The interest income arose on account of the fund so received and it may not have been utilised for a certain period of time, being put in fixed deposits so that the amount does not lie idle. That the income generated was again applied to the disbursement of grants and loans. The income generated from interest is necessarily inter-linked to the business of the appellant-Corporation and would, thus, fall under the head of 'profits and gains of business or profession'. There would, therefore, be no requirement of taking recourse to Section 56 of the IT Act for taxing the interest income under this residuary clause as income from other sources. In our view, to decide the question as to whether a particular source of income is business income, one would have to look to the notions of what is the business activity. The activity from which the income is derived must have a set purpose. The business activity of the appellant-Corporation is really that of an intermediary to lend money or give grants. Thus, the generation of interest income in support of this only business (not even primary) for a period of time when the funds are lying idle, and utilised for the same purpose would ultimately be taxable as business income. The fact that the appellant-Corporation does not carry on business activity for profit motive is not

material as profit making is not an essential ingredient on account of self-imposed and innate restriction arising from the very statute which creates the appellant-Corporation and the very purpose for which the appellant-Corporation has been set up. Our view finds support from the judgment in ***The Sole Trustee, Lok Shikshana Trust v. The Commissioner of Income Tax, Mysore.***[5]

24. In view of the aforesaid finding the crucial issue would be whether the amounts advanced as grants from this income generated could be adjusted against the income to reduce the impact of taxation as a revenue expense. If it is revenue expense the amount can be deducted but if it is capital expense then the answer would be in the negative.

25. The facts before us clearly set out that undoubtedly the amount received to be advanced as loans and grants by the appellant-Corporation from the Central Government are treated as capital receipts. In fact, if it was otherwise, they would have become taxable in the hands of the appellant-Corporation. Over this, there is no dispute. The line of argument on behalf of the appellant-Corporation was, however, predicated on a plea that assuming it to be so, the grants (and not loans)

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5 (1976) 1 SCC 254

cannot be treated as a capital expenditure as neither any enduring advantage or benefit has accrued to the appellant-Corporation nor has any asset come into existence which belongs to or was owned by the appellant-Corporation. Thus, what may be a capital receipt in the hands of the appellant-Corporation may still be a revenue expenditure and it is in that context that the observations in ***Atherton v. British Insulated and Helsby Cables Ltd.***[6] referred to in ***Commissioner of Income Tax, Bombay v. Associated Cement Companies Ltd., Bombay***[7] were relied upon. The context was slightly different in those cases because if an expenditure was to bring into existence an asset or advantage for enduring benefit of the trade, it was opined that a case could be made out attributed not to revenue but to capital. In this case, of course, this proposition is really the reverse and advantage was sought to be taken of the aforesaid principle.

26. We are not in disagreement with the aforesaid proposition to the extent that there can be an amount treated as a capital receipt while the same amount expended may be a revenue expenditure. The question is whether this is so in the present case.

6(supra)
7(supra)

27. No doubt the interest income is not directly received as a capital amount. It is actually generated by utilising the capital receipts when the fund is lying idle though the income so generated is then applied for the very objective for which the appellant-Corporation was set up, i.e., disbursement of grants and advancement of loans. The impugned judgment of the High Court appears to us to have dealt with both loans and grants, but the question of references framed, and which is a position accepted before us, is that the dispute related to only grants. It was not the appellant-Corporation's case that the amounts advanced as loans, the same being payable with interest, could be adjusted as expenses against the business income generated by investing the amounts and consequently earning interest on the same. The argument was predicated on a reasoning that since the interest generated is treated as a business income, the grants made, which would never come back, should be adjustable as expenses against the same. In fact, to the extent grants were returned back, the CIT(A) did not allow the entire deduction as claimed for but only did so qua the amount which was disbursed as grant and never received back.

28. To decide the aforesaid question, it would be appropriate to advert

to the very purpose for which the statutory appellant-Corporation has been set up. It is in this context that we have set out the functions of the appellant-Corporation in para 3 hereinabove, i.e., to advance loans or grant subsidies to State Governments for financing cooperative societies, etc. There is no other function which the appellant-Corporation carries out nor does it generate any funds of its own from any other business. In a sense the role is confined to receiving funds from the Central Government and appropriately advancing the same as loans, grants or subsidies. In a larger canvas the appellant-Corporation plans, promotes and makes financial programmes for the benefit of these societies and other entities to which such loans, grants and subsidies are advanced. We may say it is really in the nature of an intermediary with expertise in the financial sector to carry forward the intent of the Central Government to assist State Governments, Cooperative Societies, etc. Since this is the business activity, that is what has persuaded us to opine that the income generated in the form of interest on the unutilised capital is in the nature of business income. The objectives are wholly socio-economic and the amounts received including grants come with a prior stipulation for the funds received to be passed on to the downstream entities. This is the

reason they have been treated as capital receipts. However, we are unable to opine that since this is a pass-through entity on the basis of a statutory obligation, the advancement of loans and grants is not a business activity, when really it is the only business activity. Once it is business activity, the interest generated on the unutilised capital has been held by us to be the business income.

29. We are unable to accept the contention of the Revenue Department that merely because the interest income received has merged with the monies in the common Fund it loses its revenue character and becomes a capital receipt. This line of argument is inconsistent with the position where interest money is received, it is held to be of revenue character, and chargeable to tax under the head 'Profits and Gains of Business or Profession'. This amount while lying in the same fund cannot acquire the character of a capital receipt. The interest having been treated as revenue receipt on which taxes are paid, it must continue to retain the character of revenue receipt. If the nature of receipt is treated as capital receipt then consistent with the aforesaid approach, no taxes would have been payable on the amount. The corollary is that all expenses incurred in connection with the business are deductible.

30. The legal position, which emerges is that if an assessee carries on business, all that is required to be seen is whether any outlay constitutes an expenditure ‘for the purpose of business’ as used in Section 37(1) of the IT Act. The provision reads as under:

> “37. General. – (1) Any expenditure (not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession".”

The disbursement of grants has already been held to be the core business of the appellant-Corporation. Once that requirement is satisfied, the expenditure incurred in the course of business and for the ‘purpose of business’, would naturally be an allowable deduction under Section 37(1) of the IT Act. The source of funds from which the expenditure is made is not relevant. It is also not really relevant as to whether the expenditure is incurred out of the corpus funds or from the interest income earned by the appellant-Corporation.

31. We are also unable to accept the contention of the respondent that the payouts constitute a mere application of income, which does not

tantamount to expenditure. The disbursement of non-refundable grants is an integral part of business of the appellant-Corporation as contemplated under Section 13(1) of the NCDC Act and, thus, is for the purpose of its business. The purpose is direct; merely because the grants benefit a third party, it would not render the disbursement as 'application of income' and not expenditure.

32. In support of the aforesaid view, we may rely on the judgment of this Court in ***CIT Kerala, Ernakulam v. The Travancore Sugar & Chemicals Ltd.***,[8] which gave an occasion to examine the issue whether the discharge of an obligation paid to the Government was application of income or diversion of profits. This Court came to the conclusion that from any point of view, whether as revenue expenditure or as an overriding charge of the profit-making apparatus or laid out and expended wholly and exclusively for the purposes of trade, this was an allowable revenue expenditure.

33. The logical conclusion is that every application of income towards business objective of the appellant-Corporation is a business expenditure and nothing else. The endeavour of the Revenue Department to rely on

8 (1973) 3 SCC 274 (more specifically para 23)

the judgment in the ***Sitaldas Tirathdas case***[9] is not appreciable since that was a case dealing with the obligation of an individual who was compelled to apply a portion of his income for the maintenance of persons whom he was under a personal and legal obligation to maintain. The IT Act does not permit any deduction from the total income in such circumstances.

34. We also find really no force in the submission of the Revenue Department that the direct nexus of monies given as outright grants from the taxable interest income cannot be distinctly identified. This is a question of fact. The plea of the respondents is based on a pure conjecture. It is the case of the appellant-Corporation throughout that it can easily demonstrate the direct and proximate nexus of interest earned through grants made, as its accounts were duly audited. In fact, CIT(A) allowed the business expenditure only to a certain amount on the basis of the facts and figures as emerged from the balance sheet. This is a burden which was to be discharged by the appellant-Corporation and the CIT(A) had been satisfied with the nexus of interest income with the disbursement of grants made, as having been established.

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9 (supra)

35. We may also note another principle to test the proposition, i.e., of diversion by overriding title. This principle was originally set out in the ***Sitaldas Tirathdas case***[10] and the *pr*inciple has been since followed. If a portion of income arising out of a corpus held by the assessee consumed for the purposes of meeting some recurring expenditure arising out of an obligation imposed on the assessee by a contract or by statute or by own volition or by the law of the land and if the income before it reaches the hands of the assessee is already diverted away by a superior title the portion passed or liable to be passed on is not the income of the assessee. The test, thus, is what amounts to application of income and what is the diversion by overriding title. The principle, in a sense would apply, if the Act or the Rules framed thereunder or other binding directions bind the institution to spend the interest income on disbursal of grants.

36. The appellant-Corporation has devised a procedure of sanction/disbursal of its system for institutional development of cooperatives. The appellant-Corporation actually supplements the efforts of the State Governments. Thus, State Governments recommend proposals of individual societies/projects to the appellant-Corporation in

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10 (supra)

a prescribed systematic format and that society may also avail direct funding of projects under various schemes of assistance on fulfillment of stipulated conditions. The formal sanction is thereafter conveyed to the State Government or the Society as the case may be and the release of funds depends on progress of implementation and is on a non-reimbursement basis. Part of the funds are advanced as loans ranging from a period 3 to 8 years with rate of interest varying from time to time, while another part is applied to grants, which are not received back naturally. This *modus-operandi* has also been set out as a stand of the appellant-Corporation as contained in para 5 of the assessment order.

37. The NCDC Act does not specify as to who should be the grantee; what should be amount to be granted. All that is prescribed is that the business of the appellant-Corporation is to provide loans or grants for the avowed object for which it has been set up. The decision with regard to who should get the grant is taken by the appellant-Corporation directly in the course of, and for the purpose of its business. Thus, the amount agreed to be given should be given as a loan or grant, or both is entirely at the business discretion of the appellant-Corporation. No grantee has a superior title to the funds. Hence, this is not a case of diversion of

income by overriding title.

38. We may record here that income has to be determined on the principles of commercial accountancy. There is, thus, a distinction between 'real profits' ascertained on principles of commercial accountancy. In the case of ***Poona Electric Supply Co. Ltd. v. CIT Bombay City***[11] this Court has held that income tax is on the real income. In the case of a business, the profits must be arrived at on ordinary commercial principles. The scheme of the IT Act requires the determination of 'real income' on the basis of ordinary commercial principles of accountancy. To determine the 'real income', permissible expenses are required to be set off. In this behalf, we may also usefully refer to the judgment in ***CIT, Gujarat v. S.C. Kothari***[12] where the following principle was laid down:

> "6. …The tax collector cannot be heard to say that he will bring the gross receipts to tax. He can only tax profits of a trade or business. That cannot be done without deducting the losses and the legitimate expenses of the business..."

There is, thus, a clear distinction between deductions made for ascertaining real profits and thereafter distributions made out of profits.

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11 (1965) 3 SCR 818
12 (1972) 4 SCC 402

The distribution would be application of income. There is also a distinction between real profits ascertained on commercial principles and profits fixed by a statute for a specific purpose. Income tax is a tax on real income.

39. We may also note that even though in the own view of the appellant-Corporation for preceding years in question, it never claimed any such adjustments, but that of course does not preclude the right of the appellant-Corporation as they sought to make out a case of mistake at a subsequent date.

40. We may also note another statutory development. The Finance Act of 2003 added a provision in Section 36 of the IT Act as sub-clause (1) (xii) in the following terms:

> "36. Other deductions. – (1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28 –
>
> (i) to (xi) xxxx
>
> (xii) any expenditure (not being in the nature of capital expenditure) incurred by a corporation or a body corporate, by whatever name called, if, -

(a) It is constituted or established by a Central, State or Provincial Act;

(b) Such corporation or body corporate, having regard to the objects and purposes of the Act referred to in sub-clause (a), is notified by the Central Government in the Official Gazette for the purposes of this clause; and

(c) The expenditure is incurred for the objects and purposes authorised by the Act under which it is constituted or established;

xxx"

41. The amendment has to be appreciated in the context of the Departmental Circular No.7/2003 dated 5.9.2003, which provides for deduction for expenditure incurred by entities established under any Central, State or Provincial Act. Entities that are created under an Act of Parliament have the basic object and function of carrying on developmental activities in the areas as specified in the said Acts. By the Finance Act, 2001 and the Finance Act, 2002, tax exemption of certain bodies set up through an Act of Parliament was withdrawn. Subsequent to the removal of the tax shield, a doubt has arisen that some of the activities having no profit motive being carried on by such entities cannot be said to be business and therefore, expenditure incurred on such developmental activities may not be allowed as a deduction when

computing the income under the head ‘profits and gains of business or profession’.

42. The Finance Act, 2003, thus, inserted a new clause mentioned aforesaid so as to provide that an expenditure not being capital expenditure incurred by a corporation or body corporate, by whatever name called, constituted or established by a Central, State or Provincial Act for the objects and purposes authorised by such Act under which such corporation or body corporate was constituted or established, shall be allowed as a deduction in computing the income under the head ‘profits and gains of business or profession’. The amendment had been introduced into the Act with effect from 1.4.2002.[13]

43. The question, thus, arises whether prior to this amendment such expenses were not allowable under the prevailing tax regime for such entitles which were not exempt from tax. In the years prior to the amendment, as we are dealing with AY 1976-77 onwards, the tax jurisprudence has evolved on the basis of ordinary principles of commercial accountancy for determining the taxable income. Thus, prior

13 Chaturvedi & Pithisaria’s Income Tax Law, Volume 3, Sixth Edition (2014), Pg. 3310, published by LexisNexis

to insertion of this sub-clause, such expenses would be permissible under the general Section 37(1) of the IT Act, which provides for deduction of permissible expenses on principles of commercial accountancy. Post amendment, such expenses get allowed under the specific section, viz. Section 36(1)(xii) after the amendment by the Finance Act, 2003.

44. We would, thus, like to conclude that we are unable to agree with the findings arrived at by the AO, ITAT and the High Court albeit for different reasons and concur with the view taken by the CIT(A) for the reasons set out hereinbefore. It is, thus, left to this Court as stated above to strike the final blow and allow the appeals, leaving the parties to bear their own costs, while noticing with regret the inordinately long passage of time and the wastage of judicial time on deciding, who is principally right when in either eventuality it benefits the Central Government.

Postscript 1:

1. The Indian legal system is reeling under a docket explosion. The Government and public authorities are active contributories to this deluge. To top it, a number of litigations arise *inter se* the

Government and its bodies and, thus, the only question, as stated in the beginning, is which pocket of the Government will be benefitted?

2. The aforesaid position resulted in a judicial innovation with the Supreme Court passing orders in ***Oil and Natural Gas Commission & Anr. v. Collector of Central Excise***[14] requiring that such cases must be referred to a Committee to be appointed by the Government to facilitate a resolution of such disputes and that no case should be filed without the approval of this Committee. This system was a failure as is apparent from the facts of the present case, where the SLP filed by the appellant-Corporation was initially dismissed with liberty to revive the same in case the High Powered Committee granted such a permission which was so granted in a meeting held on 14.08.2009. The said Committee discussed the legal ramifications, and in some way opined in favour of the appellant-Corporation, as is apparent from the discussion aforesaid. But the ball was again lobbed back into the Court to adjudicate the said issue rather than a resolution being reached. The result was only the revival of the appeal, and the consequent decision which has seen the light of the day only now.

14 1995 Supp (4) SCC 541

3. The aforesaid failure of the system resulted in the Supreme Court recalling its orders in the *ONGC cases* vide ***Electronics Corporation of India v. Union of India.***[15]

4. The Central Government and the State authorities have been repeatedly emphasising that they have evolved a litigation policy. Our experience is that it is observed more in breach. The approach is one of bringing everything to the highest level before this Court, so that there is no responsibility in the decision-making process – an unfortunate situation which creates unnecessary burden on the judicial system. This aspect has also been commented upon in a judgment of this Court in ***Union of India & Ors. v. Pirthwi Singh & Ors.***,[16] albeit between the Government and the private parties, where the question of law had been settled and yet the appeal was filed only to invite a dismissal. The object appears to be that a certificate for dismissal is obtained from the highest court so that a quietus could be put to the matter in the Government Departments. Undoubtedly, this is

15 (2011) 332 ITR 58 (SC)
16 (2018) 16 SCC 363

complete wastage of judicial time and in various orders of this Court it has been categorized as “certificate cases”, i.e., the purpose of which is only to obtain this certificate of dismissal.

5. The 126th Law Commission of India Report titled ‘Government and Public Sector Undertaking Litigation Policy and Strategies’ debated the Government versus Government matters which weighed heavily on the time of the Courts as well as the public exchequer. This was as far back as in 1988. It was only in the year 2010 that the National Litigation Policy (for short ‘NLP’) was formulated with the aim of reducing litigation and making the Government an efficient and responsible litigant. Five (5) years later it reportedly saw a revision to increase its efficacy, but it has hardly made an impact. In the year 2018, the Central Government gave its approval towards strengthening the resolution of commercial disputes of Central Public Sector Enterprises (for short ‘CPSEs’)/ Port Trusts *inter se*, as well as between CPSEs and other Government Departments/Organisations. The aim was and is to put in place a mechanism within the Government for promoting a speedy resolution of disputes of this

kind, however it excluded disputes relating to Railways, **Income Tax**, Customs and Excise Departments. It has now been made applicable to all disputes other than those related to **taxation** matters. This was pursuant an order passed in *The Commissioner of Income Tax (Exemptions) v. National Interest Exchange of India*[17] by a bench of which one of us (Sanjay Kishan Kaul, J.) was a part.

6. Insofar as non-taxation matters are concerned, the Administrative Mechanism for Resolution of CPSEs Disputes was conceptualised to replace the Permanent Machinery of Arbitration and to promote equity through collective efforts to resolve disputes. It has a two-tiered structure.

7. At the first level, commercial disputes will be referred to the Committee comprising Secretaries of the Administrative Ministries/Departments to which the disputing parties belong and the Secretary, Department of Legal Affairs. In case the two disputing parties belong to the same Ministry/Department, the Committee will comprise Secretary of Administrative Ministry/Department

17 SLP (C) Diary No. 35567 of 2019

concerned; the Secretary, Department of Legal Affairs and the Secretary, Department of Public Enterprises. If a dispute is between a CPSE and a State Government Department/Organisation, the Committee will comprise of the Secretary of the Ministry Department of the Union to which the CPSE belongs, the Secretary, Department of Legal Affairs and the Chief Secretary of the State concerned. Such disputes are ideally to be resolved at the first level itself within a time schedule of three (3) months, and in the eventuality of them remaining unresolved, the same may be referred to the Cabinet Secretary at the second level, whose decision will be final and binding on all concerned.

8. We are of the opinion that one of the main impediments to such a resolution, plainly speaking, is that the bureaucrats are reluctant to accept responsibility of taking such decisions, apprehending that at some future date their decision may be called into question and they may face consequences post retirement. In order to make the system function effectively, it may be appropriate to have a Committee of legal experts presided by a retired Judge to give their imprimatur to

the settlement so that such apprehensions do not come in the way of arriving at a settlement. It is our pious hope that a serious thought would be given to the aspect of dispute resolution amicably, more so in the post-COVID period.

9. In most countries, mediation has proved to be an efficacious remedy and here we are talking about mediation *inter se* the Government authorities or Government departments. India is now a signatory to the Singapore Convention on Mediation and we understand that a serious thought is being given to bring forth a comprehensive legislation to institutionalise mediation, in furtherance of this function to which India has committed itself.

Postscript 2:

10. We now turn to the issue of matters pertaining to CPSEs and Government authorities insofar as taxation matters are concerned,

because they are consistently sought to be carved out as a separate category of cases. One of the largest areas of litigation for the Government is taxation matters. The petition rate of the tax department before the Supreme Court is at 87%.[18] So, the question is can something be done about it?

11. In our opinion, a vibrant system of Advance Ruling can go a long way in reducing taxation litigation. This is not only true of these kinds of disputes but even disputes between the taxation department and private persons, who are more than willing to comply with the law of the land but find some ambiguity. Instead of first filing a return and then facing consequences from the Department because of a different perception which the Department may have, an Advance Ruling System can facilitate not only such a resolution, but also avoid the tiers of litigation which such cases go through as in the present case. In fact, before further discussing this Advance Ruling System, we can unhesitatingly say that, at least, for CPSEs and Government authorities, there would be no question of taking this matter further once an Advance Ruling is delivered, and even in case of private

18*See* 'Economic Survey 2017-19 – Volume 1' by the Department of Economic Affairs, Ministry of Finance, Government of India

persons, the scope of any further challenge is completely narrowed down.

12. It is as far back as in 1971 that a report was submitted by the Direct Taxes Enquiry Committee under the Chairmanship of Dr. K.N. Wanchoo, recognising the need for providing Advance Ruling System, particularly in cases involving foreign collaboration. The aim was to give advance rulings to taxpayers or prospective taxpayers, which would then considerably reduce the Revenue's workload and decrease the number of disputes. This finally resulted in a scheme of Advance Ruling being brought into effect in 1993, with the introduction of a new Chapter in the Income Tax Act, 1961 (hereinafter referred to as the 'IT Act'). A quasi-judicial tribunal was established as the Authority for Advance Rulings (for short 'AAR') to provide certainty and avoid litigation related to taxation of transactions involving non-residents. The scope of the transactions on which an advance ruling can be sought from the AAR has gradually increased to now include both residents and non-residents, who can seek the same for issues having a substantial tax impact. Chapter XIX-B of the IT Act deals with advance rulings and it has been defined in Section 245N(a) of the

IT Act. These rulings are binding both on the Income Tax Department and the applicant, and while there is no statutory right to appeal, the Supreme Court has held in ***Columbia Sportswear Company v. Director of Income Tax Bangalore***[19] that a challenge an advance ruling first lies before the High Court, and subsequently before the Supreme Court. The advance ruling may be reversed in the event a substantial question of general public importance arises or a similar question is already pending before the Supreme Court for adjudication.

13. The ground level situation is that this methodology has proved to be illusionary because there is an increasing number of applications pending before the AAR due to its low disposal rate and contrary to the expectation that a ruling would be given in six (6) months (as per Section 245R(6) of the IT Act), the average time taken is stated to be reaching around four (4) years![20] There is obviously lack of adequate numbers of presiding officers to deal with the volume of cases. Interestingly, the primary reason for this is the large number of

19 (2012) 11 SCC 224

20*See* Deloitte Report on Advance Rulings in India: Delivering Greater Tax Certainty (Deloitte Tax Policy Paper 5, 2019)

vacancies and delayed appointments of Members to the AAR.[21] In view of the time taken, the very purpose of AAR is defeated, resulting in the mechanism being used infrequently as is evident from the ever-increasing tax related litigation.

14. We may notice a significant development in Section 245N of the IT Act. It was through Notification No.11456 dated 3.8.2000 that public sector companies were added to the definition of 'applicant', and in 2014, it was made applicable to a resident who had undertaken one or more transactions of the value of Rs. 100 crore or more.

15. Insofar as a resident is concerned, the limit is so high that it cannot provide any solace to any individual, and we do believe that it is time to reconsider and reduce the ceiling limit, more so in terms of the recent announcement stated to be in furtherance of a tax friendly face-less regime!

16. We may refer to the international scenario where there has been an incremental shift towards mature tax regimes adopting advance

21ibid.

ruling mechanisms. The increase in global trade puts the rulings system at the centre-stage of a robust international tax cooperation regime. The Organisation for Economic Cooperation and Development (for short 'OECD') lists advance rulings as one of the indicators to assess trade facilitation policies, making it an aspirational international best practice standard. For example, Australia and New Zealand have a robust system of advance rulings wherein the decisions (which are public rulings affecting a large number of taxpayers) are given teeth by being made binding on the revenue authorities. New Zealand has gone a step further and innovated "status rulings" under which a taxpayer can apply to the Commissioner for a ruling on how a change in the law impacts an existing ruling.

17. In the United States, there is a mechanism for the Treasury to authorise guidance in the form of revenue rulings, procedures and notices. The mechanism again, has been bolstered by subsequent practice and interpretations of the United States courts, where rulings have indicated that taxpayers may be penalised if they act

inconsistently with legal interpretations set out in the revenue rulings, procedures or notices.

18. Tax transparency has been a hallmark trait of the Swedish legal system. Swedish law requires public disclosure of *ex ante* tax administration such as advance rulings. Both the taxpayer as well as the Swedish Tax Agency can request an advance tax ruling, these rulings are published without information identifying the taxpayer that requested them. The *Skatterättsnämnden*, or the Council for Advance Tax Rulings is the Swedish Government agency which is vested with this power. The advance ruling system has played a crucial role in Sweden's position as a country with one of the highest tax compliance rates in the world.

19. The aim of any properly framed advance ruling system ought to be a dialogue between taxpayers and revenue authorities to fulfil the mutually beneficial purpose for taxpayers and revenue authorities of bolstering tax compliance and boosting tax morale. This mechanism should not become another stage in the litigation process.

20. We, thus, consider it appropriate to recommend to the Central Government to consider the efficacy of the advance tax ruling system and make it more comprehensive as a tool for settlement of disputes rather than battling it through different tiers, whether private or public sectors are involved. A council for Advance Tax Ruling based on the Swedish model and the New Zealand system may be a possible way forward.

21. We have been persuaded to write two postscripts on account of the backbreaking dockets which are ever increasing and as a move towards a trust between the Tax Department and the assessee, and we hope that both the aspects meet consideration at an appropriate level.

22. In the end before parting we may refer to the legal legend Mr. Nani A. Palkhivala, who while addressing a letter of congratulations to Mr. Soli J. Sorabjee on attaining his appointment as the Attorney General on 11.12.1989 referred to the greatest glory of Attorney General as not to win cases for the Government but to ensure that

justice is done to the people. In this behalf, he refers to the motto of the Department of Justice in the United States carved out into the Rotunda of the Attorney General Office:

> "*The United States wins its case whenever justice is done to one of its citizens in the courts*."

The Indian citizenry is entitled to a hope that the aforesaid is what must be the objective of Government litigation, which should prevail even within the Indian legal system. In the words of Martin Luther King, Jr., "*We must accept finite disappointment, but never lose infinite hope*."

23. A copy of this order be sent to the Department of Revenue, Department of Expenditure and Department of Economic Affairs, Ministry of Finance and to the Ministry of Law & Justice.

...……J.
[Sanjay Kishan Kaul]

...……J.
[Indu Malhotra]

New Delhi.
September 11, 2020.