IN THE ITAT HYDERABAD BENCH 'B'

My Home Power Ltd.

v.

Deputy Commissioner of Income-tax, Central Circle - 7

CHANDRA POOJARI, ACCOUNTANT MEMBER

AND SAKTIJIT DEY, JUDICIAL MEMBER

IT APPEAL NO. 1114 (HYD.) OF 2009

[ASSESSMENT YEAR 2007-08]

NOVEMBER 2, 2012

ORDER

Chandra Poojari, Accountant Member - This appeal by the assessee is directed against the order of the CIT(A)-I, Hyderabad dated 15th October, 2009 for assessment year 2007-08.

2. The assessee raised the following grounds of appeal:

1. The order of the learned CIT(A) is erroneous both on facts and in law.

2. The learned CIT(A) erred in finalising the appeal without providing proper opportunity to the appellant.

3. The learned CIT(A) erred in holding that the amount realised by transferring Carbon Credits - CER (Certified Emission Reductions) represent income from transfer of goods and that the entire amount was realised on sale of such goods represents income of the appellant.

4. The learned CIT(A) erred in holding that realisation of the Carbon Credits represent the revenue receipt and not a capital receipt and further erred in confirming the addition of Rs. 11,75,00,000 made by the Assessing Officer.

5. Without prejudice to the above, the learned CIT(A) erred in holding that the amount realised on Carbon Credits is not eligible for deduction u/s. 80IA of the IT Act.

6. The learned CIT(A) erred in confirming the order of the Assessing Officer in determining the total income of the appellant at Rs. 8,99,61,870 by treating the realisation from carbon credits of Rs. 11.75 crores as the taxable income of the appellant.

3. Brief facts of the issue are that the assessee had filed return of income for the assessment year under consideration on 28.2.2008 showing a loss of Rs. 86,54,970. The company is engaged in the business of power generation through biomass power generation unit. During the year under consideration it has received 1,74,037 Carbon Emission Reduction Certificates (CERs) popularly known as 'carbon credits' for the project activity of switching off fossil fuel from naphtha and diesel to biomass. It has sold 1,70,556 CERs to a foreign company M/s. Noble Carbon Credits Ltd., Ireland and had received an amount of Rs. 12.87 crores. The assessee had accounted this receipt as capital in nature and had not offered the same for taxation. The Assessing Officer dealt in detail the taxability of sale proceeds arising out of the sale of CERs and held the same to be a revenue receipt since the CERs are a tradable commodity and even quoted in stock exchange. Accordingly, added the net receipt of Rs. 11,75,00,000 to the returned income. After `giving effect to set off of brought forward losses the total income was determined at Rs. 8,99,61,870 and tax demand of Rs. 3,60,80,529 was raised. Being aggrieved, the assessee went in appeal before the CIT(A). The CIT(A) confirmed the order of the also and also given a finding that the amount which was considered as income of the assessee cannot be considered as income from business and as such the same is not entitled for deduction u/s. 80IA of the Act. Against this the assessee is in appeal before us.

4. The learned AR submitted that for arriving at the conclusions, the first attempt is to know the nature of the receipt. The company's main business activity is generation of biomass based power. The receipt in question has no relationship with the process of production nor it is connected with the sale of power or with the raw material consumed. It is not even the sale proceed of any bye product. The CERCs are issued to every industry which saves emission of carbon and not limited to power projects. Further, the certificates were issued keeping in view the production relating to periods earlier to the previous year under consideration. The amount is not a compensation for the loss suffered in the process of production or expenditure incurred in acquisition of capital assets.

5. The AR submitted that the certificate issued by the United Nations Framework Convention on Climate Change (UNFCCC), Kyoto Protocol only indicates the achievement made by the assessee company in emitting lesser quantity of gases than the assigned quantity. It does not mention about either revenue or capital expenditure incurred by the assessee. The certificate by itself does not have any value unless there are other industries which are in need of such certificates. The certificate is not dependent on production. In a hypothetical situation where all the Industries in the world are able to limit emission of gases to the assigned level there would not be any value for the certificates issued by UNFCCC. The process of business commences from purchase of raw material and ends with the sale of finished product. The gain is not within any of the process in between and does not represent receipt to compensate the loss suffered in the process. Therefore, the amount does not represent any income in the process or during the course of business.

6. He submitted that the said amount does not represent subsidy for establishing the industry or for purchase of raw material or a capital asset. The UNFCCC does not reimburse either revenue or capital expenditure. In fact the UNFCCC does not provide any funds to the industry. It only certifies that the industry emitted a particular quantity of gases as against the permissible quantity. It is not, therefore, a subsidy granted to reimburse the losses. No payment is in fact

made by the UNFCCC but only a certificate is issued without any consideration of profit or loss or the acquisition of capital assets. The amount cannot be considered to be a perquisite as this is not received from any person having a business connection with the company and is not received in the process of carrying on the business. The perquisites are those provided in addition to the profits or benefits by the beneficiaries. It is defined to be an incidental emolument in addition to the fixed income unless there exists a business connection no such benefit can be derived.

7. The learned AR submitted that, Therefore, the amount is not falling within any of the clauses of Sec. 2(24) of the I.T. Act. The amount also would not represent an incentive granted in the process of business activity as the amount is not received under any scheme framed by the Government or anybody to benefit the industry or to reimburse either the cost of the raw material or the cost of capital asset. The amount also cannot be considered as an award for the revenue loss suffered by the company as the amount is granted without relevance to the financial gains or losses. The payment is made absolutely without any relevance to the financial transactions of the assessee. There is no consideration for paying this amount. The amount is paid in the interest of international community and not either in the interest of Industry as such or in the interest of the assessee company or as a compensation for the loss/ expenditure during the course of business. Therefore, the amount is a sort of a gift given by the UNFCCC for the distinction achieved by the assessee company in achieving emission of lesser amount of gases than the "assigned amount". It cannot, therefore, be an income within the meaning of Sec. 2(24) or Sec. 28 of the LT. Act, 1961.

8. The learned AR submitted that the provisions of Sec. 2(24) define the word "income" which clearly indicates that this type of receipts are not covered by the said provision. No doubt sub section (24) of section 2 only provides inclusive definition for the word "Income". Even if it is an inclusive definition, it is to be considered whether the amount received by the company falls within any of the categories of income mentioned in the said sub section or not. This type of receipt is not included in the said sub section as income. The amount does not represent any consideration in the process of its business activity. As already mentioned in the earlier paragraph, the amount is not fitting within any of the items mentioned in Sec. 2(24) of the LT. Act nor relates to the year of account.

9. The AR further submitted that similar situations arose in the past. Certificates were issued by the Government for export of goods which were capable of sale. The sale consideration is held as not relating to the Industrial undertaking and was held to be related to the export promotion scheme announced by the Government (*CIT* v. *Sterling Foods* [1999] 237 ITR 579/104 Taxman 204 (SC) at page 209). In the said situation, export is a part of trade and the certificate is granted during the course of and in connection with the export trade. Some other certificates were issued against payment of duty against purchase of raw material and such certificates acted as reimbursement of excise duty suffered. In the instant case the certificates are to be attributed to the climatic protection, which is not a part of the business. The scheme by UNFCCC is in the interest of Global protection from pollution and has no relevance to the business activities of the assessee. Therefore, the assessee is in a better situation for claiming exemption. Such certificates are later included as income both in Sec. 2(24) and in Sec. 28. The certificates received by the assessee are not included as income within Sec. 2(24) or in Sec. 28 of the Act. An attempt is made to include the same in DTC in the year 2010 itself and DTC is not introduced as Act so far.

Though the DTC included the certificates as income, the Parliament in its wisdom did not amend the IT Act. Therefore, the intention of the Parliament is not to tax the CERs, otherwise when the same is included as income in the bill of DTC, there is no other reason as to why the same is not included in Sec. 2(24) or Sec. 28.

10. The AR submitted that in the past, industries received grants, subsidies and incentives. The treatment for such amount, may also be relevant. They are discussed hereunder w.r.t. the circulars issued by the CBDT

1. The CBDT in circular No. 142 dated 1-8-1974 reported in 95 ITR page 131(ST) observed that the subsidy received under this scheme for helping the growth of industries which is not meant for supplementing the profits is considered as not taxable. In the present case there is no question of supplementing the profits.

2. Circular No. 447 dated 22.1.1986 wherein the Board advised that award received by an amateur Sportsman is not taxable in his hands as it is a capital receipt.

11. The AR submitted that the assessee's case is far better than the above two situations. There is some relevant to the activities. But in the case of the assessee there is no relevance. In the above mentioned circulars, the CBDT expressed a view that if the amount is paid by way of subsidy to the industries established in the backward and remote areas would not represent the income. According to the CBDT if the amount is paid by the Government towards loss suffered on revenue account, such subsidy would be taxable. In case the subsidy is on capital account, it is a capital receipt and in case the subsidy is not for any of the two, then also such subsidy is to be treated as capital receipt and should be exempted. This is the view expressed by various judicial pronouncements as discussed hereinafter.

12. The AR submitted that the above circulars are cited just to show that the amount received otherwise than revenue account is not assessable as the income and does not represent revenue receipt. In the case of the assessee company, the amount received does not represent the compensation for the loss on revenue account. This amount also does not represent a gain during business activities. The amount also does not reimburse any capital expenditure. A reading of the following decisions of various courts would also indicate clearly that such receipts do not represent income of the company. The Andhra Pradesh High Court in the case of *CIT* v. *Chitrakalpa* reported in 177 ITR 540 held that subsidy received by the producer for the production of feature films in the state are capital in nature. It was also held that the said amount cannot be considered as the income of the assessee. The decision of the Gauhati High Court in the case of *Lachit Films* v. *CIT* 195 ITR 402 - The Gauhati High Court was considered the question whether the Grants-in-aid received by the assessee from the government for production of films is a revenue receipt or not. The Hon'ble High Court held that the Grants-in-aid was not a product of normal business activity and therefore, is not a revenue receipt. The Kerala High Court in the case of *CIT* v. *225 ITR 394 Udaya Pictures Private Ltd.*, also held the same view that the subsidy received by the producer of Cinematograph Films is not taxable. The Madras High Court in the case of *CIT* v. *Kanyakumari District Co- operative Spinning Mills Ltd*., 128 Taxman 544 held that the subsidy received from the State Government for recruiting the Adi Dravidas by the assessee as capital in nature. The Calcutta High Court in the case of *CIT* v.

Anand and Company reported in 233 ITR page 18 observed that subsidy received from Federation without rendering any services is in the nature of voluntary assistance is in the nature of gift and further held that the same is not includable for the purpose of income. The Karnataka High Court in the case of *CIT* v. *Gogte Minerals* reported in 222 ITR page 245 observed that development grant received by an assessee for acquiring machinery and replacing the old machinery is capital in nature. The Kerala High Court in the case of *CIT* v. *Rajagiri Rubber and Projects Company Ltd.*, reported in 182 ITR 393 held that subsidy received by a Rubber Plantation for replanting rubber trees under the re- plantation subsidy scheme is not taxable income. The Kerala High Court in the case of *CIT* v. *Rubi Rubber Works Ltd.*, 178 ITR 181 observed that subsidy given for beneficial purposes of promoting public interest is capital receipt and not a revenue receipt.

13. The AR further relied on the decision of the Punjab and Haryana High Court in the case of *Baghapurana Cooperative Marketing Society Ltd.*, v. *CIT* 44 Taxman 92 held that subsidy received by the Cooperative Marketing Society from Markfed is capital receipt and is exempt from tax. The decision of the Calcutta Bench-B in the case of *Magnum Exports Pvt. Ltd.* v *ACIT* reported in 54 ITD 425 wherein it is held that income on sale of export licence is a capital receipt. The Kerala High Court (Full bench) in the case of *CIT* v. *Ruby Rubber Works Ltd.*, reported in 178 ITR 181 held that the rubber subsidy received is a capital receipt since it was for a public purpose and not with a view to reimburse the expenses incurred. The said decision of the Kerala High Court has the approval of the Hon'ble Supreme Court in the case of *Kalpataru Estates Ltd.*, v. *CIT* reported in 221 ITR 601.

14. He further relied on The Calcutta High Court in the case of *CIT* v. *Balrampur Chinni Mills Ltd.*, reported in 238 ITR 445 held that the surplus of the sale consideration permitted to be collected by the company with a stipulation to use same in repaying the loans taken from financial institutions is held as capital income. The Madras High Court in the case of *CIT* v. *Madhurakantan Co-operative Sugar Mills* reported in 263 ITR 388 held that the amount collected on sale of molasses is not income to the company as the said amount is to be utilized for the purpose of acquisition of the specified assets. There are various other decisions to the effect that such receipts are capital in nature.

15. The AR submitted that the Assessing Officer relied on the following decisions and the said decisions have no application to the facts of the case, in view of the explanations submitted hereunder:

(*a*) The Assessing Officer relied on the decision of the Hon'ble Supreme Court in the case of *Tata Consultancy Services* v. *State of Andhra Pradesh* reported in 271 ITR 401. According to the Assessing Officer, the CERs represent goods as they are capable of marketing. The said case has no application-to the facts of the assessee's case. In the said case, the company is engaged in the business of sale of computer software packages. The question was whether the items traded in are goods or not for the purpose of Sales Tax. The case of the assessee is totally different. The CERs were not the stock in trade of the assessee. There is no relevance of the decision of the Supreme Court to the case of the assessee's case.

(*b*) The Assessing Officer also relied on the decision of the Supreme Court in the case of *Bharat Sanchar Nigam Ltd.*, v. *Union of India* reported in 282 ITR 273 to state that the CERs are goods. The Supreme Court was considering the case of BSNL which supplies the tele communication system. The Apex Court was considering the question whether the electromagnetic waves or the radio frequencies are the goods or not. The Hon'ble Supreme Court held that the radio frequencies are not goods. There is absolutely no relevance of the said decision to the facts of the assessee's case.

(*c*) The Assessing Officer relied upon the decision of the House of Lords in the case of *Pontypride and Rhondda Joint' Water Board* v. *Ostime (H.M. Inspector of Tax)*, [1946] 14 ITR 45. In the said case, the House of Lords are dealing with a situation where subsidies from public funds were provided in carrying on the business are in the nature of profits and gains. It was found by the House of Lords that the subsidy received were to meet an estimated deficiency in the operation loss/trading activity and observed that the amounts were admittedly paid during the trading activity. The said case has no application to the facts of the assessee's case. The House of Lords are dealing with a situation where the subsidy was granted to reimburse the loss suffered by the Water Board. The amount received by the assessee is not such a receipt. Therefore, the decision of the House of Lords has no application to the facts of the assessee's case. Similar is the view taken in the case of *Smart* v. *Lincolnshire Sugar Co. Ltd.*, reported in 20 TCU 643 referred to by the Assessing Officer. The Assessing Officer himself mentioned that the amount of subsidy was provided to subsidize the trading receipts. Therefore, the said case has no application to the facts of the assessee's case.

(*d*) The Assessing Officer also referred to the decision of Supreme Court in the case of *V.S.S.V. Meenakshi Achi* v. *CIT* reported in 60 ITR 253. In the said case, the Supreme Court found that the amount from the funds were earmarked for the assessee on the basis of the rubber produced by them and were paid against the expenditure incurred by them for maintaining the labour and producing the rubber. The facts in the said case indicate that the subsidy was received by the assessee to compensate the revenue expenditure incurred in the process of the trading activity which has absolutely no relevance to the facts of the assessee's case.

16. The AR submitted that from the analysis of the decisions cited by the assessee or the Assessing Officer, it can be seen that the subsidies granted are categorized into three types.

(*a*) Subsidy granted to compensate the trading loss or a manufacturing loss which is held as a revenue receipt.

(*b*) Subsidy granted to compensate the capital investment, purchase of specified plant and machinery etc. This subsidy is held to be capital receipt and also held that the same shall be reduced from the cost of the capital asset for the purpose of arriving at the depreciation.

(*c*) Subsidy granted for the public good is held as not taxable and not deductable from capital asset.

17. The AR submitted that in so far as the amount received from the International organizations, it is submitted that such amount is for public good and not to compensate either the revenue

expenditure or the capital expenditure and, therefore, is not taxable. From the above explanations, it is clear that the subsidy received by a person unconnected with the trading or manufacture and meant for promotion of public good is capital in nature. It is clear from various decisions that any subsidy which compensate revenue expenditure is revenue in nature and which compensate revenue expenditure is revenue in nature and which compensates capital expenditure is capital in nature. When it is neither, the same cannot be included as income.

18. The AR submitted that the amount received is not to compensation either revenue type of expenditure nor the capital expenditure incurred by the assessee. Therefore, the said amount can neither be reduced from the cost of the assets nor added to the income of the assessee. Therefore, the assessee requests the Honourable Income-tax Appellate Tribunal to kindly consider the above explanations and allow the appeal holding that the amount received from CERs does not represent the revenue income.

19. Alternatively, the AR submitted that the amount received is not related to the business activity and that it does not represent a revenue receipt. The assessee explained as to how the amount cannot be considered as a revenue receipt. Without prejudice to any of the submissions, the assessee requests the Tribunal to kindly consider the following claims:

(*a*) If as held by the Assessing Officer (as per the extract at para 8 (c) above the amount represents a revenue receipt connected with the business activity, the same cannot be held as relating to the year of account as the certificate related to the emission of carbon during the earlier years. It is submitted in the earlier paragraphs that the CERs do not relate to the year of account. Hence, the income is not assessable for the assessment year under consideration.

(*b*) Even if it were to be considered as a revenue receipt for the year under consideration, it is to be exempt u/s. 80IA as the Assessing Officer himself clearly mentioned that it is connected to the production of power. In the words of the Assessing Officer they are directly linked to the generation of power. Therefore, the assessee would be entitled for deduction u/s. 80IA of the Act.

(*c*) With regard to rejection of the claim for deduction u/s. 80IA, the Assessing Officer relied on the decision of the Supreme Court in the case of *Cambay Electric Supply Industrial Co., Ltd.*, v. *CIT* reported in 113 ITR 84. The Supreme Court in the said case held that the income attributable to cover the receipts from sources other than the actual conduct of the business of the specific nature also is eligible for deduction. However, the Assessing Officer is of the view that the said decision was referred as the word 'attributable' as used in Sec. 80I and whereas the word 'derived from' is used in Sec. 80IA of the Act. Therefore, the Assessing Officer relied on the decision of the Supreme Court in the case of *Ashok Leyland* v. *CIT* reported in 224 ITR 122. In the said case, the Supreme Court considered the allowability of deduction u/s 80IA of the IT Act. The question before the Supreme Court was where the profit derived from sale of imported parts can be said to be attributable to the priority nature or not. The Supreme Court held that the receipt from sources other than the actual conduct of the business of generation and distribution of electricity also is eligible for deduction. Both the decisions referred to above i.e. 113 ITR 84 and 224 ITR 122 are in favour of the assessee and do not support the view of the Assessing Officer.

(*d*) The Assessing Officer relied on the decision of the Supreme Court in the case of *Sterling Foods* v. *CIT* reported in 237 ITR 579 and the decision of the Madras High Court in the case of *Pandian Chemicals Ltd.*, v. *CIT* reported in 233 ITR 497. According to the Assessing Officer, the gain on sale of import entitlements is not attributable to the industrial activity and, therefore, the exemption u/s. 80IA is not allowed.

(*e*) The decisions of Punjab & Haryana High Courts in the case of *Liberty Shoes Ltd.* v. *CIT* reported in 293 ITR 478, *Liberty India* v. *CIT* reported in 293 ITR 520 and *Shakti Foot Wear* v. *JCIT* reported in 13 DTR 157 were also relied upon by the Assessing Officer.

(*f*) In this regard, the AR submitted that there is difference between the decision of the Apex Court and the facts of the assessee's case. In the case of the appellant, the Assessing Officer already held that the CERs are directly linked with the production of power and in the cases decided by various courts the same was in dispute.

(*g*) It is further submitted that firstly, the sale of import licenses is held as business receipt as the same is included in Sec. 28 of the IT Act. In so far as the grant of CERs is concerned, the same does not represent income within the meaning of Sec. 28 of the IT Act. Further, the Assessing Officer at page No. 5 of the assessment order extracted in the above mentioned paragraphs observed that the amount is directly attributable to the business of production of power. When the Assessing Officer after holding that the receipt is attributable to the business activity, cannot now say that the income is not derived from the industrial activity for the purposes of sec. 80IA of the IT Act. The observations of the Assessing Officer and the CIT (appeals) are contradictory.

(*h*) Further, if it is related to production relating to earlier years, the expenditure relatable to earning of certificates has to be arrived at by taking into consideration the assets used and the material consumed in the earlier years and such amount has to be reduced. The net income can only be subjected to tax and not the gross receipt. The certification report gives the data based on which such certificates are issued. The expenditure attributable to such activities has to be reduced from the receipts.

20. Without prejudice to any of the contentions, if the second view expressed by the learned CIT(A) that CERs represent goods were to be considered, as submitted earlier the said goods are capital goods and cannot be considered as stock in trade. The learned CIT (A) held that the certificates are akin to stocks or shares. In such an event, they represent capital goods The gain would be subject to tax as capital gain. In such an event, it is submitted that there is no cost of acquisition of such capital asset and hence the gain cannot be subject to capital gains in view of the decision of the Supreme Court in the case of *CIT* v. *RC Srinivasa Setty* reported in 128 ITR 294. It is further submitted that the amount spent for registration of the claim cannot be considered as the cost of acquisition. It only represents the process Cost for making applications etc. This view is supported by the decision of the ITAT, Hyderabad Bench in the case of *ITO* v. *Uppala Venkatarao* reported in 83 ITD 273. On the other hand if it were to be held that there is cost forming part of the manufacturing process, the proportion has to be determined and the cost suffered from the inception of the company has to be arrived at in which case there would be no gain. In view of the above submissions, the AR submitted that the Tribunal may pass appropriate orders allowing the appeal.

21. The learned DR submitted that the only grievance of the assessee is that the sale from out of transfer/sale of CERs popularly known as carbon credit is not taxable as per the provisions of the IT Act and if at all it is taxable, the provision of section 80IA would apply for said receipts. The concept of carbon trading is in its budding/infancy phase. But no doubt the growth of this business is tremendous worldwide. The concern for global warming arising out of emission of harmful gases into atmosphere, more precisely the emission of carbon dioxide has given rise to this concept of carbon trading. The famous Kyoto protocol tried to solve this global concern of high degree of emission of harmful gases. The idea was to divide the entire world into two, one which can make changes in the existing infrastructure and one who cannot. The idea behind this was that each country will have to cut down their emission by some percentage or else have to pay heavy fine by way of measuring how much they are polluting the air. This has given rise to the concept of "clean development mechanism'(CDM) which is a project executed in a country where they cannot on their own afford to bring that technological change in the existing industry, which can result in less carbon emission. For example, a company in a developed world would lend money to a company in a developing world to buy the necessary technology and in turn own units generated by bringing the technology change and thus meet the target set. This will help the developing countries to get much needed financial help and in turn help the developed countries to meet the emission cut targets set by their government. If the company in the developing country ends up with excess units than the permissible limit, it can sell the same for some profit out of it. Thus, the underlying intention behind the technological implementation by a company in the developing world is not only to reduce the pollution of atmosphere but also to earn some profit from out of excess units that can be generated by implementation of the CDM project. The Assessing Officer while considering the receipt to be revenue in nature has relied on the decision of Hon'ble Supreme Court in the case of *TATA Consultancy Services* v. *State of Andhra Pradesh*. The rationale laid down by Hon'ble Supreme Court in the above mentioned case is squarely applicable to the case of the assessee. In that case while dealing with the issue of levy of sales tax on computer software, the Hon'ble Supreme Court held that a 'goods' may be tangible property or intangible property. It would become 'goods' provided it has the attributes thereof with regard to (a) its utility (b) capability of being bought and sold (c) capability of being transmitted, transferred, delivered, stored and possess. The CER credits can be considered as 'goods' as they have all the attributes of goods as laid down in the decision of Hon'ble Supreme Court. This approach was reiterated by the Supreme Court in the case of *BSNL* v. *Union of India* [2006] (282 ITR 273). The different clauses in the purchase agreement between the assessee company and M/s. Noble Carbon Credit, Ireland clearly indicate that the sale transaction of CER is nothing but a transaction in 'goods'. The agreement had different clauses regarding the contract quantity, contract price, date of delivery and the receipt thereof, which are' basically the attributes in a transaction of sale of goods.

22. The DR submitted that, otherwise also, this issue can be viewed from a different angle. The assessee submitted that the certificates are in recognition of the achievement for reducing the pollution. No doubt by implementing the CDM Project the assessee gets the benefit of efficiency in respect of reducing the pollution. Had there been no other benefit attached to it, in the normal situation, the assessee company would not have bothered for obtaining the CERs. It is because whatever expenditure is incurred for implementation of the project as a pollution reduction measure, the assessee would have got the benefit of the expenditure incurred by claiming it in its profit and loss account. Since there is something more to this and since it is known that the

certificates issued by UNFCCC have intrinsic value and has a ready market for its redemption/ trading, that the assessee obviously pursued to obtain the said certificates. He submitted that 'carbon credits' has a ready market worldwide and it is understood that these are also quoted in the international market. For Example there is regular trading in Carbon credit in European Climate Exchange based at London where the trading is apparently web-based. Similar trading also takes place through the website of Nordpool.com a Norway based website, Bluenext.com a Paris based website and Chicago Climate Exchange, Chicago USA. Of late, the trading has apparently commenced in India through MCX (Multi Commodity Exchange) and NCDEX (National commodity and derivative Exchange). Thus the certificates (CERs) are akin to shares or stock which are transacted in the stock exchange. Hence, the sale proceeds arising out of sale of the CERs by the assessee is a revenue receipt and rightly brought to tax by the Assessing Officer. Accordingly, the DR submitted that the stand taken by the Assessing Officer is justified and the receipt arising out of the sale of CERs is revenue in nature and hence taxable.

23. The DR submitted that the next question is whether the said receipt will entitle the assessee to claim deduction u/s. 80IA. The view of the Assessing Officer that the said receipts are not directly and inextricably related to the business of the undertaking is justified. It is obvious that generation and sale of CER is not the business of the assessee. However, the said CERs accrued to the assessee in view of implementation of the CDM project for its existing business the basic purpose of which was reduction of pollution. To that extent, though the CERs are accrued in course of the business operations of the assessee but are not directly connected to the business of the industrial undertaking. It is only incidental to the business. The Assessing Officer has relied on the decision of Hon'ble Punjab and Haryana High Court in the case of *Liberty Shoe Ltd* v. *CIT* and *Liberty India* v. *CIT* reported in 293 ITR. The Assessing Officer has also relied on the decision of Supreme Court in the case of Sterling Food Ltd and the decision of Madras High Court in the case of Pandian Chemicals. The contention of the assessee is that once the assessee qualifies for deduction u/s. 80IA of the Act by being covered by the description industrial undertaking any profit earned by the business of the assessee was eligible for deduction and it was not necessary that the business must be from the activity of the industrial undertaking. It has been held by various courts that if the income is from a different and independent source, the same may not be eligible for deduction u/s, 80IA/80IB. In the context of DEPB benefits, the Hon'ble Punjab and Haryana High Court held that for application of the words "derived from" there must be a direct nexus between profits and gains and the industrial undertaking. The income of the assessee from duty draw back cannot be held to be income derived from specified business. This view of Hon'ble Punjab and Haryana High Court has been confirmed by the Hon'ble Supreme court referred to above. Since the income from sale of CERs is independent of the main business of power generation it cannot be said that the receipt from sale of CERs would automatically be entitled for deduction u/s. 80IA by virtue of the fact that the power generation business of the assessee is entitled for deduction u/s. 80IA. Thus the argument of the assessee is not acceptable and hence deserves to be rejected. The judicial decisions relied upon by the assessee in its submission relate to taxability of subsidy. Accordingly, the sale proceeds of the CERs cannot be equated with subsidy and hence the applicability of the case-law relied on by the assessee does not arise. Thus, considering the totality of the facts, the DR was of the view that the Assessing Officer has rightly rejected the claim of deduction u/s. 80IA of the Act.

24. We have heard both the parties and perused the material on record. Carbon credit is in the nature of "an entitlement" received to improve world atmosphere and environment reducing carbon, heat and gas emissions. The entitlement earned for carbon credits can, at best, be regarded as a capital receipt and cannot be taxed as a revenue receipt. It is not generated or created due to carrying on business but it is accrued due to "world concern". It has been made available assuming character of transferable right or entitlement only due to world concern. The source of carbon credit is world concern and environment. Due to that the assessee gets a privilege in the nature of transfer of carbon credits. Thus, the amount received for carbon credits has no element of profit or gain and it cannot be subjected to tax in any manner under any head of income. It is not liable for tax for the assessment year under consideration in terms of sections 2(24), 28, 45 and 56 of the Income-tax Act, 1961. Carbon credits are made available to the assessee on account of saving of energy consumption and not because of its business. Further, in our opinion, carbon credits cannot be considered as a bi-product. It is a credit given to the assessee under the Kyoto Protocol and because of international understanding. Thus, the assessees who have surplus carbon credits can sell them to other assessees to have capped emission commitment under the Kyoto Protocol. Transferable carbon credit is not a result or incidence of one's business and it is a credit for reducing emissions. The persons having carbon credits get benefit by selling the same to a person who needs carbon credits to overcome one's negative point carbon credit. The amount received is not received for producing and/or selling any product, bi-product or for rendering any service for carrying on the business. In our opinion, carbon credit is entitlement or accretion of capital and hence income earned on sale of these credits is capital receipt. For this proposition, we place reliance on the judgement of the Supreme Court in the case of *CIT* v. *Maheshwari Devi Jute Mills Ltd*. (57 ITR 36) wherein held that transfer of surplus loom hours to other mill out of those allotted to the assessee under an agreement for control of production was capital receipt and not income. Being so, the consideration received by the assessee is similar to consideration received by transferring of loom hours. The Supreme Court considered this fact and observed that taxability of payment received for sale of loom hours by the assessee is on account of exploitation of capital asset and it is capital receipt and not an income. Similarly, in the present case the assessee transferred the carbon credits like loom hours to some other concerns for certain consideration. Therefore, the receipt of such consideration cannot be considered as business income and it is a capital receipt. Accordingly, we are of the opinion that the consideration received on account of carbon credits cannot be considered as income as taxable in the assessment year under consideration. Carbon credit is not an offshoot of business but an offshoot of environmental concerns. No asset is generated in the course of business but it is generated due to environmental concerns. Credit for reducing carbon emission or greenhouse effect can be transferred to another party in need of reduction of carbon emission. It does not increase profit in any manner and does not need any expenses. It is a nature of entitlement to reduce carbon emission, however, there is no cost of acquisition or cost of production to get this entitlement. Carbon credit is not in the nature of profit or in the nature of income.

25. Further, as per guidance note on accounting for Self-generated Certified Emission Reductions (CERs) issued by the Institute of Chartered Accountants of India (ICAI) in June, 2009 states that CERs should be recognised in books when those are created by UNFCCC and/or unconditionally available to the generating entity. CERs are inventories of the generating entities as they are generated and held for the purpose of sale in ordinary course. Even though CERs are

intangible assets those should be accounted as per AS-2 (Valuation of inventories) at a cost or market price, whichever is lower. Since CERs are recognised as inventories, the generating assessee should apply AS-9 to recognise revenue in respect of sale of CERs.

26. Thus, sale of carbon credits is to be considered as capital receipt. This ground is allowed.

27. As we have decided the main issue, the alternate ground of the assessee becomes infructuous and the same is dismissed.

28. In the result, assessee's appeal is allowed.