2025 INSC 1414

REPORTABLE

IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION

CIVIL APPEAL No. 4612 OF 2014

NATIONAL COOPERATIVE DEVELOPMENT CORPORATION ...APPELLANT(S)

VERSUS

ASSISTANT COMMISSIONER OF INCOME TAX ...RESPONDENT(S)

With

CIVIL APPEAL No. 4618 OF 2014

With

CIVIL APPEAL No. 4616 OF 2014

With

CIVIL APPEAL No. 4613 OF 2014

With

CIVIL APPEAL No. 4615 OF 2014

With

CIVIL APPEAL No. 4614 OF 2014

With

CIVIL APPEAL No. 4617 OF 2014

With

CIVIL APPEAL No. 4619 OF 2014

With

CIVIL APPEAL No. 4620 OF 2014

With

CIVIL APPEAL No. 4621 OF 2014

J U D G M E N T

Table of Contents

I. Introduction

1. The question for adjudication in this batch of appeals is whether the National Co-operative Development Corporation (NCDC), appellant-assessee, is entitled to deductions under Section 36(1)(viii) of the Income Tax Act, 1961 in respect of three specific heads of income, being, (i) Dividend income on investments in shares, (ii) Interest earned on short-term deposits

with banks, and (iii) Service charges received for monitoring Sugar Development Fund loans.

1.1 Answer to this question would depend on whether these receipts qualify as "*profits derived from the business of providing long-term finance*" for industrial or agricultural development, or whether they are merely attributable to business activities falling outside the strict scope of eligibility for the statutory deduction. For the reasons to follow, we found that the legislative transition from a broader deduction regime to the restrictive "derived from" formulation by the Finance Act, 1995, manifests a clear parliamentary intent to "ring-fence" the fiscal benefit. By employing the narrowest possible connective verb "derived from" and coupling it with an exhaustive definition of "long-term finance" in the Explanation, the Legislature has explicitly excluded ancillary, incidental, or second-degree sources of income. Therefore, while agreeing with the findings of the High Court and by supplying additional reasons with supportive precedents, we have held that receipts are not profits derived from the business of providing long-term finance. We have thus dismissed the appeals.

II. Factual Background:

2. The appellant is a statutory corporation mandated to advance initiatives for the production, processing, and marketing of agricultural

produce and notified commodities in accordance with cooperative principles. The current litigation concerns several assessment years in which the appellant sought deductions under Section 36(1)(viii) of the Income Tax Act, 1961 ('the Act').

A. Findings of the Assessment Officer:

3. Dispute arose when the Assessing Officer (AO) took the appellant's return of income up for scrutiny. The AO examined the claim for deduction under Section 36(1)(viii). Having noted that the provision allows for a deduction of forty percent of profits, but strictly limits this benefit to profits *"derived from the business of providing long-term finance"* the AO found that the appellant is generally engaged in financing, and not all income receipts qualify for this specific statutory deduction.

4. By his Assessment Order dated 31.07.2006, the AO proceeded to consider each of these receipts independently. As regards the *dividend income*, the AO held that this was a return on investment in shares, which is legally distinct from interest earned on long-term loans. Similarly, with respect to the *interest on short-term bank deposits*, the AO reasoned that these accrued from the investment of idle surplus funds in the interregnum period, rather than from the core activity of providing agricultural credit. As regards *service charges* received for the Sugar Development Fund (SDF),

the AO noted that the appellant was acting merely as a nodal agency for the Central Government. The funds disbursed belonged to the government, and the appellant received a service fee for its administrative role in monitoring these loans. Consequently, the AO concluded that none of these three streams of income could be characterized as "profits derived from the business of providing long-term finance" as envisaged by the Act. Accordingly, the AO disallowed the deductions claimed on these counts and added them back to the total income of the appellant.

B. Findings of the CIT(A) and ITAT

5. Aggrieved by the Assessment Order, the appellant preferred an appeal before the Commissioner of Income Tax (Appeals). The CIT(A), vide order dated 15.11.2007, upheld the disallowances, relying heavily on the legislative intent and the definition of "long-term finance" in the Explanation to Section 36(1)(viii). This view was subsequently affirmed by the Income Tax Appellate Tribunal (ITAT) and finally by the High Court vide the impugned judgment dated 28.11.2011.

C. Findings of the High Court

6. The High Court affirmed the findings of the lower authorities. Addressing the appellant’s argument regarding *dividend income*, the High Court held that under Section 85 of the Companies Act, 1956, preference

shares are part of share capital and cannot be treated as loans. The Court reasoned that a shareholder is not a creditor and cannot sue for debt; therefore, investments in redeemable preference shares do not satisfy the definition of *"long-term finance"* which requires *a "loan or advance"* with repayment of *"interest."* Thus, dividends derived from such shares are not deductible under Section 36(1)(viii).

7. Regarding the *interest on short-term deposits*, the High Court upheld the Tribunal's finding that this income is derived from the investment of idle funds during the interregnum period. The Court concluded that such interest is a step removed from the business of providing long-term finance. Since the immediate source of this income is the bank deposit and not a long-term loan extended by the assessee, the strict requirements of the "derived from" test were not met. On the issue of *service charges* for Sugar Development Fund (SDF) loans, the High Court noted the admitted factual position that the loans were funded by the Government of India, not the appellant. The appellant merely acted as a nodal agency for monitoring and disbursement. Since the appellant’s own funds were not involved, and it received service charges rather than interest, the Court held that the appellant could not be considered to be carrying on the business of providing long-term finance in

this specific context. Consequently, this income stream was also excluded from the deduction.

8. We heard Ms. Christi Jain, the learned counsel appearing on behalf of the appellant, Ms. Jain ably assisted the court by analyzing the provisions and drawing our attention to the relevant precedents. On behalf of the revenue, we heard the Additional Solicitor General Mr. Raghavendra P. Shankar, assisted by Ms. Madhulika Upadhyay, learned counsel.

III. Analysis and Findings

A. Re: Section 36(1)(viii) of the Income Tax Act, 1961, and the objective of the 1995 Finance Act amendment.

9. The relevant statutory provision, Section 36(1)(viii) allows for a specific deduction in computing the income referred to in Section 28. The section provides a deduction in respect of any financial corporation engaged in providing long-term finance for industrial or agricultural development. The deduction is capped at an amount not exceeding forty percent of the ***"profits derived from such business of providing long-term finance."*** Crucially, the Explanation to the section defines ***"long-term finance"*** to mean any loan or advance where the terms provide for repayment along with interest during a period of not less than five years. The relevant parts of the provision necessary for the adjudication of this dispute are reproduced below:

> *"Section 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—*
> *…*
> *(viii) in respect of any special reserve created and maintained by a* ***financial corporation which is engaged in providing long-term finance for industrial or agricultural development or development of infrastructure facility in India*** *or …, an amount not exceeding forty per cent of the* ***profits derived from such business of providing long-term finance*** *(computed under the head "Profits and gains of business or profession" before making any deduction under this clause…*
>
> *Explanation – in this clause,*
> *(a) ….*
> *(e)* ***"long term finance"*** *means any loan or advance where the terms under which money are* ***loaned or advanced provide for repayment along with interest thereof during a period of not less than five years."***
>
> (emphasis supplied)

10. This strict framework was introduced intentionally by the Finance Act, 1995. Before this amendment, the provision allowed deductions based on the "total income" of the corporation. Parliament noticed that financial corporations were diversifying into activities unrelated to agricultural financing but were still claiming tax benefits on their entire profit. The amendment was introduced to fix this "mischief" by ensuring that the deduction is restricted only to profits that come directly from the core activity of providing long-term credit.

11. This intent is explicitly stated in the Memorandum explaining the Finance Bill, 1995, which explains why the amendment was necessary. The relevant portion reads as follows:

> *"Under clause (viii) of sub-section (1) of Section 36 of the Income Tax Act, 1961, an approved financial corporation engaged in providing long term finance for industrial or agricultural development in India, or an approved public company formed and registered in India with the main object of carrying on business of providing long term finance for construction or purchase of residential houses, is entitled for deduction of an amount not exceeding 40 per cent of its total income carried to a special reserve. The deduction is allowed on the "total income" and not with reference to the income from the activities specified in Section 36 (1) (viii).*
>
> *These organizations have diversified their activities and are claiming deduction under this section even in respect of their incomes from activities other than those specified in this section. This is no justification for allowing the deduction with reference to income from other activities or from sources other than business, it is therefore proposed to limit the deduction of 40% only to the income derived from providing long term finance for the activities specified in Section 36(1)(viii). It will thus take outside the purview of deduction, income arising from other business activities or from sources other than business."*

12. The Memorandum explaining the Finance Bill, 1995, as delineated above, explicitly states that the objective of such amendment was to limit the deduction of 40% only to the income derived from providing long-term finance thereby taking it out of the deduction for income arising from other business activities. To accept the appellant's argument that all its income is deductible because it is a statutory corporation would be to restore the pre-amendment position and render the legislative change otiose. The conditions under Section 36(1)(viii) are cumulative; the deduction is limited to *"profits derived from such business"* and *"long-term finance"* is as defined in the

Explanation, as a loan or advance with a repayment period of not less than five years.

B. Re: Interpretation of the phrase “derived from”

13. The appellant contends that the phrase "derived from" should be interpreted broadly. Relying on *CIT v. Meghalaya Steels Ltd.*[1] it is argued that if a receipt flows directly from the business and is chargeable under Section 28, the assessee qualifies for the said deductions. Also, that the distinction between "attributable to" and "derived from" is artificial when the business is indivisible. Conversely, the Respondent submits that judicial authority has consistently held that "derived from" signifies a strict, first-degree nexus. For this proposition the ASG relied on *CIT v. Sterling Foods*[2], *Pandian Chemicals Ltd. v. CIT*[3] and *Liberty India v. CIT*[4].

14. Resolution of the competing perspectives would depend on the interpretation of the expression *"derived from."* We find merit in the respondent's submission that this phrase connotes a requirement of a direct, first-degree nexus between the income and the specified business activity. It is judicially settled that "derived from" is narrower than "attributable to", this distinction was lucidly clarified by this Court in *Cambay Electric Supply*

[1] (2016) 6 SCC 747.
[2] (1999) 4 SCC 98.
[3] (2003) 5 SCC 590.
[4] (2009) 9 SCC 328.

Industrial Co. Ltd. v. CIT[5], where it was held that the legislature uses "derived from" when it intends to give a restricted meaning. The relevant part of the judgment is extracted hereunder:

> *"8. As regards the aspect emerging from the expression "attributable to" occurring in the phrase "profits and gains attributable to the business of" the specified industry (here generation and distribution of electricity) on which the learned Solicitor General relied, it will be pertinent to observe that the Legislature has deliberately used the expression "attributable to" and not the expression "derived from". It cannot be disputed that the expression "attributable to" is certainly wider in import than the expression "derived from". Had the expression "derived from" been used it could have with some force been contended that a balancing charge arising from the sale of old machinery and buildings cannot be regarded as profits and gains derived from the conduct of the business of generation and distribution of electricity…."*

15. The phrase *"derived from"* whether used alone or as "derived from the business of" appears across multiple provisions of the Act, such as Section 80HHC and Section 80JJA. This Court has consistently held that this phrase requires a direct and proximate connection, or a "first-degree nexus," between the income and the specific activity. The addition of the words "the business of" simply clarifies which activity is the source; it does not dilute the requirement for a direct link. Any interpretation suggesting otherwise would upset settled law.

16. The appellant's reliance on the decision in *Meghalaya Steels* (supra) is misplaced because the facts in that case were fundamentally different. In

[5] (1978) 2 SCC 644.

Meghalaya Steels (supra), this Court interpreted Section 80-IB, which allowed deductions for profits derived from "any business" of an industrial undertaking. The income in dispute there consisted of specific government subsidies given to reimburse the company for actual operational costs like transport, power, and insurance. The Court held that since these subsidies were essentially paying back the costs incurred to run the factory, they had a direct link to the profits of the business. Importantly, that judgment did not change the strict rule regarding the phrase "derived from" established in earlier cases; it merely applied the rule to a specific situation involving cost reimbursement,

17. The present case, however, stands on a completely different footing. Unlike Section 80-IB which applies to "any business," Section 36(1)(viii) is extremely narrow and restricts the deduction strictly to profits derived from "such business of providing long-term finance". The disputed income here is not a reimbursement of business costs, nor does it come from the core activity of long-term lending. Therefore, the reasoning in *Meghalaya Steels* cannot be applied here to expand the scope of the deduction, as the specific statutory requirements and the nature of the income are entirely distinct.

18. Furthermore, we must address and reject the appellant's attempt to portray its operations as a "single, indivisible integrated activity" to claim the

deduction on all receipts. This specific argument was conclusively dealt with by this Court in *Orissa State Warehousing Corpn. v. CIT*[6], where the assessee sought to claim an exemption under Section 10(29) for interest income on the ground that it was part of its integrated warehousing business.

19. In *Orissa State Warehousing Corpn.* (supra), this Court held that fiscal statutes must be construed strictly based on the plain language used. The Court explicitly rejected the "integrated activity" theory, holding:

> *"40. "In fine thus, a fiscal statute shall have to be interpreted on the basis of the language used therein and not dehors the same. No words ought to be added and only the language used ought to be considered so as to ascertain the proper meaning and intent of the legislation. The court is to ascribe natural and ordinary meaning to the words used by the legislature and the court ought not, under any circumstances, to substitute its own impression and ideas in place of the legislative intent as is available from a plain reading of the statutory provisions.*
>
> *41. In the premises, we do feel it expedient to record that by reason of the clarity of expression, the question of there being any integrated activity being exempt within the meaning of Section 10(29) of the Act does not and cannot arise. The Madhya Pradesh High Court has correctly applied the law and the comparison effected with other provisions are pointers to the distinction and the same cannot but be termed to be in accordance with the golden rule of construction in the matter of interpretation of statutes."*

20. The legal principles established by the decisions cited above set a strict threshold for eligibility. First, the phrase "derived from" must be interpreted much more narrowly than the phrase "attributable to". Second, it

[6] (1999) 4 SCC 197.

requires a direct or immediate nexus with the specific business activity, for if the income is even a "step removed" from the business in question, that nexus is snapped. Third, the deduction is limited to income from "first degree" sources and explicitly keeps out "ancillary profits" of the undertaking. Finally, this Court refuses to accept the argument that appellants business should be treated as a "single, indivisible and integrated activity" in order to expand the scope of a specific deduction.

C. Re: Dividend received on redeemable preference shares

21. The appellant argued that the substance of redeemable preference shares are effective loans, as fixed redemption schedule and dividend rate assimilate them to the nature of debt. Resisting this, the Respondent draws our attention to the admitted factual position that these receipts are "investments in agricultural based societies by way of contribution to share capital". The Respondent submits that under Section 85 of the Companies Act, 1956, preference shares unequivocally remain share capital and cannot be treated as loans. Reliance is placed on the Constitution Bench decision in *Bacha F. Guzdar v. CIT*[7] to demonstrate that dividends arise from the contractual relationship of shareholding, and the immediate source of the income is the investment in shares, not the activity of lending.

[7] (1954) 2 SCC 563.

22. Dividends are a return on investment dependent on the profitability of the investee company, and this distinction is fundamental to the genealogy of the income. We rely on the Constitution Bench decision in *Bacha F. Guzdar (supra)*, which established that dividend income is derived from the contractual relationship of the shareholder, not the underlying activity or the nature of the funds**,** Relevant Part of the judgement is extracted hereunder:

> *" 8. In fact and truth dividend is derived from the investment made in the shares of the company and the foundation of it rests on the contractual relations between the company and the shareholder. Dividend is not derived by a shareholder by his direct relationship with the land. There can be no doubt that the initial source which has produced the revenue is land used for agricultural purposes but to give to the words 'revenue derived from land' the unrestricted meaning, apart from its direct association or relation with the land, would be quite unwarranted. For example, the proposition that a creditor advancing money on interest to an agriculturist and receiving interest out of the produce of the lands in the hands of the agriculturist can claim exemption of tax upon the ground that it is agricultural income within the meaning of Section 4, sub-section (3)(viii), is hardly statable. The policy of the Act as gathered from the various sub-clauses of Section 2(1) appears to be to exempt agricultural income from the purview of the Income Tax Act. The object appears to be not to subject to tax either the actual tiller of the soil or any other person getting land cultivated by others for deriving benefit therefrom, but to say that the benefit intended to be conferred upon this class of persons should extend to those into whosoever hands that revenue falls, however remote the receiver of such revenue may be, is hardly warranted."*

23. Furthermore, a fundamental distinction exists between a shareholder and a creditor. The basic characteristic of a loan is that the person advancing the money has a right to sue for the debt. In stark contrast, a redeemable preference shareholder cannot sue for the money due on the shares or claim a return of the share money as a matter of right, except in the specific

eventuality of winding up. This is also the reason for this Court, in *Bacha F. Guzdar* (supra), to hold that the immediate source of dividend income is the investment in share capital and not the business of providing loans. Since the statute specifically mandates 'interest on loans', extending this fiscal benefit to 'dividends on shares' would defy the legislative intent. Therefore, we hold that dividend income does not qualify as *profits derived from business of providing long-term finance*.

D. Re: Interest on short-term deposits in banks

24. The appellant has placed heavy reliance on the decision of this Court in *National Co-operative Development Corporation v. CIT*[8]. They argue that this Court has already recognized that earning interest on idle funds is "interlinked" with their business and constitutes "business income" rather than "Income from Other Sources". Based on this, the appellant Contends that their operations are a "single, indivisible integrated activity." The appellant contends that since the funds are parked temporarily only to be eventually used for lending, the interest earned on them should be treated as effectively "derived from" the business of providing finance.

[8] (2021) 11 SCC 357.

25. We are unable to accept this submission because it confuses two different concepts i.e. the classification of income and the eligibility for a specific deduction. There is a vital distinction between the general genus of "Business Income" and the specific species of "*profits derived from the business of providing long-term finance*". Just because an income falls into the broad bucket of "Business Income" does not automatically mean it qualifies for the 40% deduction under Section 36(1)(viii) for the later specific species.

26. In *NCDC* (supra), the dispute was whether the corporation could deduct its expenses under Section 37. The revenue argued that the interest income was "Income from Other Sources," which would have prevented the corporation from deducting business expenses against it. This Court rightly held that since the funds were waiting to be lent out, the interest was "business income," and therefore, normal business expenses could be deducted. However, the present case is not about deducting expenses; it is about claiming a special incentive deduction under Section 36(1)(viii). This section is much stricter and requires more than just being "business income"; it requires the profit to be directly "derived from" long-term financing.

27. Furthermore, the NCDC judgment dealt with tax years 1976-1984. The law we are interpreting today was amended significantly by the Finance Act, 1995. Parliament specifically changed the law to narrow the scope of this deduction because financial corporations were claiming benefits on all sorts of diversified income. We cannot use a judgment based on the old, broader law to interpret the new, stricter provision. The amendment was designed precisely to stop the kind of broad "integrated business" claim the appellant is making now. In NCDC (supra) this Court merely held that interest from short-term deposits is "business income" and not income from other sources. In the present case, the Revenue does not dispute that this is business income, but would contend that Section 36(1)(viii), as a special deduction provision operates on a much narrower plane.

28. Even if a receipt is classified as "Business Income" under Section 28, it does not automatically qualify for the special deduction unless it satisfies the strict rigor of being "derived from" the specific activity of long-term finance defined in the Explanation. The legislative intent was to incentivize the specific act of providing long-term credit, not the passive investment of surplus capital. If we were to accept the appellant's argument, it would create a perverse incentive for financial corporations to park funds in safe, short-term investments and claim the 40% deduction, rather than fulfilling their

statutory mandate of providing high-risk long-term credit to the agricultural sector. Consequently, interest earned from bank deposits fails this test as it is, at best, attributable to the business, but certainly not derived from the activity of providing long-term finance.

E. Re: Service Charge on Sugar Development Fund loans

29. The appellant asserts that acting as a nodal agency for the Sugar Development Fund is part of its statutory mandate, and the service charges received are consideration for the core activity of facilitating long-term finance, irrespective of the fund's origin. Per contra, the Respondent argues that these charges are merely "service fees" or agency commissions paid by the Government of India. The respondent emphasizes that since the corpus belongs to the Government, the appellant acts as an intermediary, not as the financier providing the loan.

30. Deduction under Section 36(1)(viii) is predicated on the financial corporation "providing" the finance. In the case of SDF loans, the admitted factual position is that the funds belong to the Government of India. The appellant bears no risk and utilizes no capital of its own.

31. The receipts in question are service charges paid by the Government for the administrative tasks of monitoring and disbursement. The proximate source of this income is the agency agreement with the Government, not the

lending activity itself. A fee received for agency services cannot be equated with "profits derived from the business of providing long-term finance," which implies the deployment of the corporation's own funds and the earning of interest thereon. Consequently, this income stream is rightly excluded from the deduction.

IV. Conclusion

32. Upon a cumulative assessment of the statutory scheme and the judicial precedents cited, we are of the considered opinion that the claim of the appellant-assessee is not correct in law. The pivotal takeaway from the analysis is that Section 36(1)(viii) of the Act is not a general exemption granted to a statutory corporation for all its business activities, rather, it is a specific incentive attached strictly to the profits arising from a defined activity namely, the provision of long-term finance.

33. The legislative transition from a broader deduction regime to the restrictive "derived from" formulation by the Finance Act, 1995, manifests a clear parliamentary intent to "ring-fence" the fiscal benefit. By employing the narrowest possible connective verb "derived from" and coupling it with an exhaustive definition of "long-term finance" in the Explanation, the Legislature has explicitly excluded ancillary, incidental, or second-degree sources of income. The appellant’s contention that its functions constitute a

"single, indivisible integrated activity" must yield to the specific statutory mandate. When a fiscal statute grants a benefit based on a specific source, the concept of an integrated business cannot be utilized to expand the scope of that benefit to cover distinct streams of income that do not strictly satisfy the statutory definition.

34. We hold that a vital judicial distinction exists between the general genus of "Business Income" and the specific species of "profits derived from the business of providing long-term finance." Viewed through this lens, none of the disputed receipts satisfy the strict statutory definition.

35. For the above reasons, we see no merit in these appeals. Consequently, Civil Appeal Nos. 4612, 4618, 4616, 4613, 4615, 4614, 4617, 4619, 4620 and 4621 of 2014 arising out of the judgments of the High Court of Delhi in ITA Nos. 513, 811, 512, 1139, 1140, 810 and 1141 of 2011 dated 28.11.2011, ITA Nos. 228 and 227 of 2012 dated 10.04.2012 and ITA No. 615 of 2012 dated 02.11.2012 respectively are hereby dismissed.

36. There shall be no order as to costs.

…………………………………....J.
[PAMIDIGHANTAM SRI NARASIMHA]

…………………………………....J.
[ATUL S. CHANDURKAR]

NEW DELHI;
DECEMBER 10, 2025