

SUPREME COURT OF INDIA

Commissioner of Income Tax

Vs

Lakshmi Machine Works

(S. H. Kapadia and B. S. Reddy, JJ)

Civil Appeal No. 4409 of 2005 With Civil Appeals Nos. 2145 to 2150 of 2007; Civil Appeals Nos. 4411, 5370, 5372, 5939 and 6145 of 2005, 917, 919, 920, 1494, 1495, 2596, 2907, 3037, 3169, 3389, 3496, 3615, 3616, 3911, 3913, 4572, 4738, 5157, 5688 and 5860 of 2006 and 163, 165, 248, 431, 683, 991,

1162, 1266, 1529, 1530, 1532, 1533, 1536, 1636 and 1637 of 2007

25.04.2007

JUDGMENT

S. H. KAPADIA, J.

1. Leave granted in special leave petitions.

2. All the above civil appeals deal with a common question of law and, therefore, they are decided together by this judgment. For the sake of convenience, the facts in C. A. No. 4409 of 2005 are mentioned herein-below.

3. For the assessment year 1993-94 M/s. Lakshmi Machine Works (the assessee) filed its return of income declaring its taxable income of Rs. 50.80 lakhs. On June 10, 1994 intimation under section 143(1) (a) of the Income-tax Act, 1961 (for short, "the Act") was sent by the Department accepting

the returned income. Later on the Department issued notice under section 143(2) of the Act. One of the items for issuing the said notice was the quantum of deduction under section 80HHC of the Act. The assessee had computed the allowable deduction under section 80HHC without taking into account in the total turnover the sales tax and excise duty. The assessee was asked to explain why the total turnover should not be recomputed by including sales tax and excise duty. In this connection, the Department placed reliance on the judgment of this court in the case of *Chowringhee Sales Bureau P. Ltd. v. CIT* . The assessee objected to the above inclusion. However, that objection was dismissed by the Assessing Officer on the ground that under section 80HHC, Explanation (ba), deduction from "total turnover" was restricted only to three items, namely, profit on sale of import licence, duty drawback and CCS. The Assessing Officer further held that from the profits of business, the assessee was entitled to deduct the above three items and also brokerage, commission, interest, rent, charges or any other receipt of similar nature. Before the Assessing Officer, the assessee contended that items which cannot be regarded as profits, the question of treating those items as part of "total turnover" did not arise. The Assessing Officer treated certain miscellaneous receipts and interest receipts as part of business profits to which the assessee objected. The assessee pointed out that under section 80HHC as it stood in the assessment year 1993-94, a deduction of 10 per cent. was allowed whereas the balance 90 per cent. stood excluded from the business profits. However, the assessee's argument for non-inclusion of sales tax and excise duty was not accepted by the Assessing Officer.

4. Aggrieved by the above decision, the matter was carried in appeal to the Commissioner of Income-tax (Appeals). The appellate authority agreed with the submissions made on behalf of the assessee. It was held that sales tax and excise duty were liabilities of the assessee to the Government. They were shown separately from the value of the goods; therefore, they were not included in the "total turnover" for working out the deduction under section 80HHC.

5. Aggrieved by the said decision, the Department carried the matter in appeal to the Tribunal. Following the judgment of the Bombay High Court in the case of *CIT v. Sudarshan Chemicals Industries Ltd.* . 2000 Indlaw MUM 52, the Department's appeal stood dismissed. Hence, this civil appeal.

6. The short point which arises for consideration in this civil appeal is : whether excise duty and sales tax were includible in the "total turnover", which was the denominator in the formula contained in section 80HHC(3) as it stood in the material time. For the sake of convenience we quote here-inbelow section 80HHC:

"80HHC. Deduction in respect of profits retained for export business.-(1) Where an assessee, being an Indian company or a person (other than a company) resident in India, is engaged in the business of export out of India of any goods or merchandise to which this section applies, there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total

income of the assessee, a deduction of the profits derived by the assessee from the export of such goods or merchandise :

Provided that if the assessee, being a holder of an Export House Certificate or a Trading House Certificate (hereafter in this section referred to as an Export House or a Trading House, as the case may be), issues a certificate referred to in clause (b) of sub-section (4A), that in respect of the amount of the export turnover specified therein, the deduction under this sub-section is to be allowed to a supporting manufacturer, then the amount of deduction in the case of the assessee shall be reduced by such amount which bears to the total profits derived by the assessee from the export of trading goods, the same proportion as the amount of export turnover specified in the said certificate bears to the total export turnover of the assessee in respect of such trading goods.

(1A) Where the assessee, being a supporting manufacturer, has during the previous year, sold goods or merchandise to any Export House or Trading House in respect of which the Export House or Trading House has issued a certificate under the proviso to sub-section (1), there shall, in accordance with and subject to the provisions of this section, be allowed in computing the total income of the assessee, a deduction of the profits derived by the assessee from the sale of goods or merchandise to the Export House or Trading House in respect of which the certificate has been issued by the Export House or Trading House.

(2) (a) This section applies to all goods or merchandise, other than those specified in clause (b), if the sale proceeds of such goods or merchandise exported out of India are received in, or brought into,

India by the assessee other than the supporting manufacturer in convertible foreign exchange, within a period of six months from the end of the previous year or, where the Chief Commissioner or Commissioner is satisfied (for reasons to be recorded in writing) that the assessee is, for reasons beyond his control, unable to do so within the said period of six months, within such further period as the Chief Commissioner or Commissioner may allow in this behalf :

(b) This section does not apply to the following goods or merchandise, namely :-

(i) Mineral oil; and

(ii) Minerals and ores (other than processed minerals and ores specified in the Twelfth Schedule).

Explanation 1.-The sale proceeds referred to in clause (a) shall be deemed to have been received in

India where such sale proceeds are credited to a separate account maintained for the purpose by the assessee with any bank outside India with the approval of the Reserve Bank of India.

Explanation 2.-For the removal of doubts, it is hereby declared that where any goods or merchandise are transferred by an assessee to a branch, office, warehouse or any other establishment of the assessee situate outside India and such goods or merchandise are sold from such branch, office, warehouse or establishment, then, such transfer shall be deemed to be export out of India of such goods and merchandise and the value of such goods or merchandise declared in the shipping bill or bill of export as referred to in subsection (1) of section 50 of the Customs Act, 1962 (52 of 1962), shall, for the purposes of this section, be deemed to be the sale proceeds thereof.

(3) For the purposes of sub-section (1), -

(a) where the export out of India is of goods or merchandise manufactured or processed by the assessee, the profits derived from such export shall be the amount which bears to the profits of the business, the same proportion as the export turnover in respect of such goods bears to the total turnover of the business carried on by the assessee;

(b) Where the export out of India is of trading goods, the profits derived from such export shall be the export turnover in respect of such trading goods as reduced by the direct costs and indirect costs attributable to such export;

(c) where the export out of India is of goods or merchandise manufactured or processed by the assessee and of trading goods, the profits derived from such export shall, -

(i) in respect of the goods or merchandise manufactured or processed by the assessee, be the amount which bears to the adjusted profits of the business, the same proportion as the adjusted export turnover in respect of such goods bears to the adjusted total turnover of the business carried on by the assessee ; and

(ii) In respect of trading goods, be the export turnover in respect of such trading goods as reduced by the direct and indirect costs attributable to export of such trading goods:

Provided that the profits computed under clause (a) or clause (b) or clause (c) of this sub-section shall be further increased by the amount which bears to ninety per cent. of any sum referred to in clause (iiia) (not being profits on sale of a licence acquired from any other person), and clauses (iiib) and (iiic) of section 28, the same proportion as the export turnover bears to the total turnover of the business carried on by the assessee.

Explanation.-For the purposes of this sub-section, -

(a) 'Adjusted export turnover' means the export turnover as reduced by the export turnover in respect of trading goods ;

(b) 'Adjusted profits of the business' means the profits of the business as reduced by the profits derived from the business of export out of India of trading goods as computed in the manner provided in clause (b) of sub-section (3) ;

(c) 'Adjusted total turnover' means the total turnover of the business as reduced by the export turnover in respect of trading goods ;

(d) 'Direct costs' means costs directly attributable to the trading goods exported out of India including the purchase price of such goods ;

(e) 'Indirect costs' means costs, not being direct costs, allocated in the ratio of the export turnover in respect of trading goods to the total turnover;

(f) 'Trading goods' means goods which are not manufactured or processed by the assessee.

(3A) For the purposes of sub-section (1A), profits derived by a supporting manufacturer from the sale of goods or merchandise shall be, -

(a) in a case where the business carried on by the supporting manufacturer consists exclusively of sale of goods or merchandise to one or more Export Houses or Trading Houses, the profits of the business [] ;

(b) in a case where the business carried on by the supporting manufacturer does not consist exclusively of sale of goods or merchandise to one or more Export Houses or Trading Houses, the amount which bears to the profits of the business [] the same proportion as the turnover in respect of

sale to the respective Export House or Trading House bears to the total turnover of the business carried on by the assessee.

(4) The deduction under sub-section (1) shall not be admissible unless the assessee furnishes in the prescribed form, along with the return of income, the report of an accountant, as defined in the Explanation below sub-section (2) of section 288, certifying that the deduction has been correctly claimed in accordance with the provisions of this section.

(4A) The deduction under sub-section (1A) shall not be admissible unless the supporting manufacturer furnishes in the prescribed form along with his return of income, -

(a) the report of an accountant, as defined in the Explanation below sub-section (2) of section 288, certifying that the deduction has been correctly claimed on the basis of the profits of the supporting manufacturer in respect of his sale of goods or merchandise to the Export House or Trading House ; and

(b) A certificate from the Export House or Trading House containing such particulars as may be prescribed and verified in the manner prescribed that in respect of the export turnover mentioned in the certificate, the Export House or Trading House has not claimed the deduction under this section :

Provided that the certificate specified in clause (b) shall be duly certified by the auditor auditing the accounts of the Export House or Trading House under the provisions of this Act or under any other law.

Explanation.-For the purposes of this section, -

(a) 'convertible foreign exchange' means foreign exchange which is for the time being treated by the Reserve Bank of India as convertible foreign exchange for the purposes of the Foreign Exchange Regulation Act, 1973 (46 of 1973), and any rules made thereunder ;

(aa) 'export out of India' shall not include any transaction by way of sale or otherwise, in a shop, emporium or any other establishment situate in India, not involving clearance at any customs station as defined in the Customs Act, 1962 (52 of 1962) ;

(b) 'export turnover' means the sale proceeds, received in, or brought into India by the assessee in convertible foreign exchange in accordance with clause (a) of sub-section (2) of any goods or merchandise to which this section applies and which are exported out of India, but does not include freight or insurance attributable to the transport of the goods or merchandise beyond the customs station as defined in the Customs Act, 1962 (52 of 1962) ;

(ba) 'total turnover' shall not include freight or insurance attributable to the transport of the goods or merchandise beyond the customs station as defined in the Customs Act, 1962 (52 of 1962) :

Provided that in relation to any assessment year commencing on or after the 1st day of April, 1991, the expression 'total turnover' shall have effect as if it also excluded any sum referred to in clauses (iiia), (iiib) and (iiic) of section 28 ;(baa) 'profits of the business' means the profits of the business as computed under the head 'Profits and gains of business or profession' as reduced by-

(1) ninety per cent. of any sum referred to in clauses (iiia), (iiib) and (iiic) of section 28 or of any receipts by way of brokerage, commission, interest, rent, charges or any other receipt of a similar nature included in such profits ; and

(2) The profits of any branch, office, warehouse or any other establishment of the assessee situate outside India ;

(c) 'Export House Certificate' or 'Trading House Certificate' means a valid Export House Certificate or Trading House Certificate, as the case may be, issued by the Chief Controller of Imports and Exports, Government of India ;

(d) 'supporting manufacturer' means a person being an Indian company or a person (other than a company) resident in India, manufacturing (including processing) goods or merchandise and selling such goods or merchandise to an Export House or a Trading House for the purposes of export." (emphasis supplied)

7. A brief analysis of the above section 80HHC of the Act, as amended with effect from April 1, 1992, indicates rationalization of provisions relating to tax concession for export profits. Under section 80HHC, the exporters were allowed, in the computation of their total income, a deduction of the entire profits derived from exports. During the relevant year, there existed a dual system for computation of export profits. The first method operated in cases where the export was of goods manufactured by the tax payer. In those cases the export profit had to be computed on the basis of the ratio of "export turnover" to "total turnover". In effect, the formula was as follows:

Export turnover

80HHC concession = export profits = total profits x Total turnover

8. Where the export consisted of goods purchased from third parties (trading goods) there was a second method of computation in which the export profits were to be calculated by deducting from the export turnover, direct and indirect costs attributable to such exports. In that case the formula was as under :

80HHC concession = export profits = export turnover -(costs attributable to such exports)

9. By the Finance Act, 1992, one more amendment was made by which the Legislature declared that commission received on assignment of export orders, brokerage, interest, rent and items mentioned in section 28(iia), (iib) and (iic), should not be treated in toto as profits of the business relating to exports and only 10 per cent. thereof should be considered as the profit of the business and the balance 90 per cent. should not be included in the profits. These amendments took place with effect from April 1, 1992, the date from which the dual system of computation of export profits came into effect.

10. All assessable entities were not eligible for deduction under section 80HHC of the Act. According to section 80HHC only an Indian company or a non-company assessee who was resident in India was eligible for deduction provided he was engaged in the export business of eligible goods. Under the Income-tax Rules, 1962, Form No. 10CCAC was prescribed. We quote hereinbelow annexures A and B to the said Form 10CCAC :

"Form No. 10CCAC [See rule 18BBA (3)] Report under section 80HHC (4)/80HHC (4A) of the Income-tax Act, 1961

1.....

2. (a) I/We certify that the deduction to be claimed by the assessee under sub-section (1) of section 80HHC of the Income-tax Act, 1961, in respect of the assessment year.....is Rs.....which has been determined on the basis of the sale proceeds received by the assessee in convertible foreign exchange. The said amount has been worked out on the basis of the details in annexure A to this

Form.

(b) I/We certify that the deduction to be claimed by the assessee, as supporting manufacturer, under sub-section (1A) of section 80HHC of the Income-tax Act, 1961, in respect of the assessment year.....is Rs....., which has been determined on the basis of sales to Export House/Trading House made during the year, in respect of which a certificate has been issued by the Export House/ Trading House under the proviso to sub-section (1) of section 80HHC of the Income-tax Act, 1961. The said amount has been worked out on the basis of the details in annexure B to this Form.

3.....

Date.....

Signed

Accountant

Notes:

Annexure A

[See paragraph 2(a) of Form No. 10CCAC]

Details relating to the claim by the exporter for deduction under section 80HHC of the Income-tax Act, 1961

1. Name of the assessee

2. Assessment year

3. Total turnover of the business

4. Total export turnover
5. Total profits of the business
6. Export turnover in respect of trading goods
7. Direct cost of trading goods exported
8. Indirect cost attributable to trading goods exported
9. Total of 7 + or – 8
10. Profits from export of trading goods [6 minus 9]
11. Adjusted total turnover (3 minus 6)
12. Adjusted export turnover (4 minus 6)
13. Adjusted profits of the business (5 minus 10)
14. Profits derived by assessee from export of goods or merchandise to which section 80HHC applies, computed under sub-section (3) of section 80HHC
15. Export turnover, deduction in respect of which will be claimed by a supporting manufacturer in accordance with proviso to sub-section (1) of section 80HHC

16. Profit from the export turnover mentioned in item 15 above, calculated in accordance with proviso to sub-section (1) of section 80HHC

17. Deduction under section 80HHC to which the assessee is entitled (Item 14 minus Item 16)

18. Remarks, if any

Annexure B

[See paragraph 2(b) of Form No. 10CCAC] Details relating to the claim of the supporting manufacturer for deduction under section 80HHC of the Income-tax Act, 1961

Section A

1. Name of the assessee

2. Assessment year

3. Total turnover of the business

4. The amount of profit under the head 'Profits and gains of business of profession'

5. Total turnover in respect of sale of Export House/Trading House for which certificate is received from Export House/ Trading House

6. Profit from the turnover mentioned in item 5 above, computed under sub-section (3A) of section 80HHC

7. Remarks, if any

Section B Details of sale of Export House/Trading House

Sl No.

Name and address of the Export House/ Trading House to whom goods or merchandise were sold

Sale Invoice No. and date

Sale price

Invoice No. and date by which Export House/ Trading House has exported

Date of certificate issued by the Export House/ Trading House under clause (b) of sub-section (4A) of section 80HHC

Amount of disclaimer

1

2

3

4

5

6

7

Action Points

1. Report is to be filed along with return of income.
2. 'Total turnover' does not include cash compensatory support, duty drawback and profit on sale of import entitlement licences.
3. 'Export turnover' means the sale proceeds (excluding freight and insurance) receivable in convertible foreign exchange-See Circular No. 564, dated July 5, 1990.1
4. Report is to be obtained in respect of each year for which deduction is claimed."

11 Analyzing the above formula, as it stood at the relevant time, it is clear that the amount of deduction under section 80HHC had to be computed as under :

Business profit x export turnover + total turnover + 90 per cent. of export incentive x export turnover/total turnover

12 Therefore, in the above formula there were three concepts, namely, "business profit", "export turnover" and "total turnover". The first step was to find out the business profit. This was to be done in accordance with the provisions of section 28 to section 43 of the Act. Under section 80HHC the above three export incentives, namely, CCS, duty drawback and profit on sale of import licence, were includible in the "business profits" and, therefore, they were taxable. The Finance Act, 1992, restricted the term "export turnover" to FOB sale proceeds. However, the said Act excluded CCS, duty drawback and profit on sale of import entitlement from the term "total turnover".

13 To sum up, the amount of deduction under section 80HHC is to be computed as under:

"1. Profit of the business.-To find out 'profit of the business', the first step is to determine income under the head 'Profits and gains of business or profession' as per section 28(iia), (iib), (iic) this includes three export incentives. From the income so arrived at, deduct the following :

a. 90 per cent. of export incentive.

b. 90 per cent. of receipts by way of brokerage, commission, interest, rent, charges or other receipts of a similar nature ; and

c. profits of any branch, office, warehouse or any similar establishment of the assessee situate outside India.

2. Export turnover.-Sale proceeds received in, or brought into India, in convertible foreign exchange within the prescribed time (or

1. See Â 1990 (184) ITR 137.

within the extended time limit) minus freight and insurance attributable to the transportation of goods/merchandise beyond the customs station is export turnover for this purpose.

3. Total turnover.-From the turnover (as per books of account) the following should be deducted if these are part of turnover :

a. freight/insurance attributable to the transport of goods or merchandise beyond customs station in India ; and

b. export incentives.

4. Export incentives.-Export incentives are :

a. profits on sale of a licence granted under the Imports (Control) Order, 1955 made under the Imports and Exports (Control) Act, 1947 [section 28(iia)] ;

b. cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the Government of India [section 28(iib)] ;

c. any duty of customs or excise repaid or repayable as drawback to any person against exports under the Customs and Central Excise Duties Drawback Rules, 1971 [section 28(iic)]."

To simplify the matter we quote hereinbelow paragraph 107.13-3P1 of the Direct Taxes Ready Reckoner by Taxmann for the year 1993-94 :

"107.13-3P1 X Ltd. is engaged in manufacturing and/or processing of heavy chemical for export. For the year ending March 31, 1993, the summarized profit and loss account is as follows:

Â

Rs.

Â

Rs.

Expenses

32, 60, 000

Total turnover (of goods exported)

30, 50, 000

Net profit

10, 30, 000

Freight and insurance attributable to trans- port of goods beyond customs station

2, 40, 000

Â

Â

Export incentive under section 28(iia), (iib), (iic)

6, 50, 000

Â

Â

Brokerage, commission, rent, interest

2, 70, 000

Â

Â

Profit of foreign branch

80, 000

Â

42, 90, 000

Â

42, 90, 000

Other information-

1. Out of total expenses of Rs. 32, 60, 000 debited to profit and loss account, Rs. 51, 600 is not deductible by virtue of sections 40 and 40A. The balance amount is, however, deductible.

2. On January 13, 1993, Rs. 86, 920 is paid on account of excise duty of the previous year 1991-92. Since this amount pertains to the previous year 1991-92, it has not been debited to the aforesaid profit and loss account.

3. The company has received Rs. 24, 90, 000 in convertible foreign exchange till September 30, 1993. The company's application for obtaining extension of time under section 80HHC has been rejected by the Commissioner.

4. During the previous year 1992-93, the company gets a short-term gain of Rs. 20, 000.

5. The company is entitled for deduction under section 80-I. Compute the net income of the company for the assessment year 1993-94.

Profits and gains of business of profession:

Rs.

Net profit as profit and loss account

10, 30, 000

Add : Amount not deductible by virtue of sees. 40 and 40A

51, 600

Â

10, 81, 600

Less : Excise duty of 1991-92, deductible by virtue of section 43B[see para 49.10]

(-) 86, 920

Business income (under section 28)

9, 94, 680

Capital gains

20, 000

Gross total income

10, 14, 680

Less : Deduction:Under section 80HHC [see Note]

5, 48, 355

Under section 80-1 [i.e., 25% of Rs. 9, 94, 680]

2, 48, 670

Net income (rounded off)

2, 17, 660

Note: Computation of deduction under section 80HHC

1. Profit of the business.-It will be calculated as follows:

Income under the head 'Profits and gains of business or profession'

9, 94, 680

Less: 90% of export incentives (i.e., 90% of Rs. 6, 50, 000)

(-) 5, 85, 000

90% of brokerage, commission, rent and interest (i.e., 90% of Rs. 2, 70, 000)

(-) 2, 43, 000

Profit of the foreign branch

(-) 80, 000

Profit of the business

86, 680

2. Export turnover.-It is Rs. 24, 90, 000 being the brought to India (within the time limit), in the convertible foreign exchange.

3. Total turnover.-It is Rs. 30, 50, 000.

4. Export incentive.-Export incentive is Rs. 6, 50, 000. Amount of deduction is as follows:

$$(\text{Rs. } 86,680 \times \text{Rs. } 24,90,000 / .30,50,000) + (90\% \text{ of Rs. } 6,50,000 \times \text{Rs. } 24,90,000 / .30,50,000) = \text{Rs. } 5,48,355.$$