
(2014) 07 AP CK 0040
In the Andhra Pradesh High Court
Case No : R.C. No. 78 of 2000

Aurobindo Pharma Limited

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 11-07-2014

Acts Referred:

Income Tax Act, 1961 — Section 256(1), 28, 80HHC, 80HHC(4C)

Citation : (2015) 370 ITR 216

Hon'ble Judges : L.N. Reddy, J;Challa Kodanda Ram, J

Bench : Division Bench

Advocate : S. Ravi, Advocate for the Appellant; S.R. Ashok, Advocate for the Respondent

Judgement

L. Narasimha Reddy, J.—The Income Tax Appellate Tribunal, Hyderabad Bench referred the following questions to this Court, through its order, dated 24.01.2000:

1. Whether on the facts and in the circumstances of the case the Tribunal was correct in law in its interpretation on the computation of relief under the provisions of S. 80HHC?

2. Whether on the facts and in the circumstances of the case the Tribunal was right in law in holding that for the purposes of computation of deduction under S. 80HHC, 90% of the receipts on the sale of scrap and conversion charges were to be excluded?

2. Briefly stated, the facts are that the applicant is a pharmaceuticals company and apart from manufacturing drugs for being sold and used in India, it manufactures items for export also. In the ordinary course, the applicant acquires raw-material, manufactures drugs according to its own expertise and markets the products. In addition to such activity, the applicant undertakes to process the raw-material supplied to it by the other manufacturing companies and hands over the end products to such companies, by levying, what are known

as conversion charges.

3. The Parliament provided for incentive to the exporters of various products. Section 80HHC of the Income Tax Act, 1961 (for short the Act) was added through Finance Act, 1985 in this behalf. It provides for deduction in respect of profits retained for export business. Sub-section (3) thereof is to the effect that the profits of a manufacturing company, referable to export of the merchandise or manufactured goods shall bear the same proportion, as does the export turnover, to the total turnover of the business of the assessee. The profits of the assessee in the business become relevant in this context. Clause (baa) of the Explanation to Section 80HHC(4C) of the Act (for short the Clause) prescribes the procedure for computation of profits of the business, in this context. Certain amounts, such as brokerage, commission, interest are required to be reduced from profits and gains of business or profession to the extent of 90%.

4. While processing the income tax returns of the applicant, submitted for the assessment year 1992-93, the Income Tax Officer proposed to deduct the conversion charges from the profits and gains of business or profession for the purpose of determining the profits of the business. An order in this behalf was passed by the Income Tax Officer.

5. The applicant filed an appeal before the Commissioner of income tax (Appeals). The appeal was dismissed through order, dated 20.03.1995. Thereupon, the applicant filed I.T.A.No.1103/Hyd/95 before the Tribunal. Through its order, dated 03.12.1997, the Tribunal dismissed the appeal. On an application submitted u/s 256(1) of the Act, the Tribunal referred the two questions mentioned above:

Sri S.Ravi, learned senior counsel appearing for the applicant submits that the interpretation placed on Section 80HHC of the Act, by the Income Tax Appellate Commissioner and the Tribunal is contrary to law and settled principles. He submits that what are deductible u/s 80HHC of the Act and the Clause are only the amounts that are received by an assessee in an activity unrelated to the manufacture and that there was no justification in treating the conversion charges, as falling in that category. He submits that mere use of the word charges to describe the amount levied for conversion of the raw material supplied by a third party, into product and handing over the same, would not bring it on par with the category of amounts mentioned under that provision. Learned senior counsel further submits that any amount, which is derived or earned through the process of manufacture, irrespective of the fact whether the end product is marketed by the assessee or was handed over to the customer, must be treated as part of the total turnover. He contends that the Parliament has evolved a complicated but balancing Act of enabling a company, undertaking export of products to get the benefit of making it dependable upon the proportion between the turnover of the exported goods on the one hand and the total turnover, on the other and that the view taken by the Tribunal and other authorities have the effect of disturbing the balance.

6. Sri S.R.Ashok, learned Standing Counsel for the Department, on the other hand, submits that by virtue of the very description, the conversion charges fall into the category, referred to in the Clause. He submits that the objective underlying Section 80HHC of the Act is to (a) differentiate, to the extent possible, the component of profit from unrelated accrual (b) to permit deduction. According to the learned senior counsel, just as the amounts representing brokerage, commission, interest, rent mentioned in the Clause do not form part of the total turnover of the business referred to in sub-section (3) of Section 80HHC of the Act, the conversion charges also do not form part of the turn over. He submits that the Income Tax Officer, the Appellate Commissioner and the Tribunal have concurrently held on facts, that the amount representing conversion charges is liable to be deducted under the Clause and that the questions framed by the Tribunal deserve to be answered against the applicant.

7. Both the learned senior counsel placed reliance upon certain decided cases.

8. Sections 80A to 80D of the Act were introduced through Fianc Act, 1965, providing for certain deductions from income. As and how the industrial and business activity has grown, categories of deductions have also increased. One just cannot state with precession, the total categories of deductions that are permissible under Chapter VI-A. The Chapter undergoes phenomenal change in every financial year.

9. Section 80HHC of the Act itself runs into six closely printed pages and it reflects almost a comprehensive code in the context of deduction in respect of profits retained for export business. One of the reasons for the bulk of the Section is that many manufacturing units undertake export of part of their products and a substantial part is marketed within the country. Since the profits, that are earned from export business alone are permitted to be deducted, a comprehensive procedure is prescribed to segregate the profits from export business, from the returns of the remaining business. Sub- section (3) of Section 80HHC of the Act provides guidance in this behalf, which reads:

(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;

(remaining part of the provision is omitted, since it is not necessary)

10. The expression profits of the business employed in clause (a) of sub-section (3) of Section 80HHC of the Act becomes relevant. A semblance of definition

thereof is provided under the Clause, which reads:

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 percent of any sum referred to in clauses (iiia), (iiib), (iiic), (iiid) and (iiie) 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.

11. From a perusal of both the provisions referred to above, it becomes clear that the ratio between the turnover in respect of the exported goods on the one hand and the total turnover of the business carried by the assessee on the other hand would reflect the ratio between the profits of export and the rest of the business. This method appears to have been evolved with a view to cushion the uncertainty in one sector, with the profits earned in the other sector and vice versa. For instance, if the total turnover of the business of an assessee is Rs.10,00,000/-, the turnover in respect of exported goods is Rs.4,00,000/- and the company has earned total profit of Rs.3,00,000/-, the profit earned through export shall be deemed to be 40% thereof, amounting to Rs.1,20,000/-. This is irrespective of the actual profit that has been earned through export.

12. The actual difficulty is experienced in arriving at the profits of the business. Indiscriminate posting of profits may result in loss to the revenue, since the proportion of the investment for export goods would have a bearing upon the profits also.

13. With a view to avoid the indiscriminate addition to the profits and gains of business or profession, the Clause mandates that the items mentioned therein must be deducted to the extent of 90%. The effort is only to ensure that the benefit of deduction provided in respect of profits, retained for export business is not claimed vis-?-vis the unrelated items. To the extent, the items are mentioned in the provision, there does not exist any difficulty for deduction from the total profits in the ordinary parlance. To arrive at the profits of business which is an expression coined specifically for the purpose of the Section, not only the items mentioned therein i.e., brokerage, commission, interest and rent, but also charges or any other receipt of similar nature are to be deducted. The whole controversy is as to whether the conversion charges earned by the applicant can be deducted from the profits and gains of the business, to arrive at the profits of the business mentioned under the Clause.

14. To our mind, the common factor that warrants the grouping of the items mentioned in the Clause is their being unrelated to the activity of the business of manufacture, which is exclusively or partly of export items. In other words, if the amount has anything to do with the activity of manufacturing, though not of export goods, deduction thereof cannot be made. Otherwise, the proportion of

the profit earned through export to the total profit gets disturbed.

15. The Commissioner of Income Tax vs. Bangalore Clothing Company was a case, in which the assessee not only carried out the activity of manufacture and export of its own, but also took up the job work of other manufactures. The question arose as to whether the charges levied for job work can be treated, on par with the items mentioned in the Clause. The answer was in the negative. In The Commissioner of Income Tax vs. K.Ravindranathan Nair, the Supreme Court affirmed that view. In that case, the assessee was a processor of cashew nuts and apart from processing its own product, it has undertaken the products of others also. The assessee did not add the processing charges to the turnover at all. It was held that such amount is liable to be added to the turnover. However, at one place of the judgment, it was mentioned that such amount must be deducted along with other items mentioned in the Clause. In the subsequent judgment in ACG Associated Capsules Pvt. Ltd. vs. Commissioner of Income Tax, the Hon''ble Supreme Court held that the question as to the deductions to be made under the Clause did not fall for consideration in Commissioner, Income Tax, Thiruvananthapuram Vs. K. Ravindranathan Nair, . The result is that the view expressed by the Bombay High Court in Commissioner of Income Tax Vs. Bangalore Clothing Co., holds the field.

16. Therefore, We are of the view that the amounts that can be treated as falling in the category of brokerage, commission, interest, rent, charges occurring in the Clause are only those items, which are unrelated to, and other than the amounts forming part of total turn over of the business carried on by the assessee occurring in sub- section (3) of Section 80HHC of the Act. Sine the conversion charges are earned through the activity of manufacturing, though for the benefit of other customers, the question of deducting the same from the general profits, in the context of arriving at profits from business under the Clause does not arise.

17. Therefore, the questions are answered in favour of the applicant i.e., the assessee.