

(2010) 10 P&H CK 0021

In the Punjab And Haryana At Chandigarh

Case No : IT Appeal No's. 28, 31, 32, 90 and 114 of 2002, 42 of 2003, 5 of 2004 and 92 of 2005 & ITA No's. 31, 28, 32, 90 and 114 of 2002, 42 of 2003, 5 of 2004 and 92 of 2005

Commissioner of Income Tax

APPELLANT

Vs

Bicycle Wheels (India)

RESPONDENT

Date of Decision : 11-10-2010

Acts Referred:

Income Tax Act, 1961 — Section 260A, 28, 80HH, 80HHC, 80HHC(1)

Citation : (2011) 335 ITR 384 : (2012) 20 TAXMAN 442

Hon'ble Judges : Ajay Kumar Mittal, J;A.K. Goel, J

Bench : Division Bench

Advocate : Denesh Goel, for the Appellant; Pankaj Jain, for the Respondent

Final Decision : Allowed

Judgement

Ajay Kumar Mittal, J.—This order shall dispose of I. T. A. Nos. 31, 28, 32, 90, 114 of 2002, 42 of 2003, 5 of 2004 and 92 of 2005 as common questions of law are involved therein. However, the facts are being extracted from I. T. A. No. 31 of 2002. The Revenue has preferred this appeal u/s 260A of the income tax Act, 1961 (in short "the Act"), against the order dated July 19, 2001, passed by the income tax Appellate Tribunal, Chandigarh Bench, Chandigarh (in short "the Tribunal"), in I. T. A. Nos. 1244/Chd/93, I. T. A. Nos. 623 and 624/Chandi/94 for the assessment years 1991-92, 1989-90 and 1990-91 respectively. The Revenue has claimed the following substantial questions of law for consideration in this appeal:

(i) Whether, on the facts and in the circumstances of the case, the hon'ble income tax Appellate Tribunal was right in law in holding that sale of scrap in India is not a part of total turnover of the respondent-firm for the purposes of calculation of deduction u/s 80HHC?

(ii) Whether, on the facts and in the circumstances of the case, the income tax

Appellate Tribunal was justified in ignoring the sale of scrap in computing the total turnover, when such generation was a by-product of manufacturing process?

(iii) Whether, on the facts and in the circumstances of the case, a by-product in a manufacturing process is not eligible for being considered in computation of the total turnover for computing section 80HHC deduction?

2. The aforesaid questions of law being inter-related are taken up together for decision. The solitary issue that would require determination is whether the scrap which had been generated during the manufacturing process and was sold in the domestic market would form part of the total turnover.

3. Briefly the facts which are essential for the decision of the appeal may be noticed.

4. The assessee is a registered firm. The return of income for the assessment year 1989-90 was filed on October 30, 1989, declaring "nil" income. The Assessing Officer during the course of assessment proceedings noticed that the assessee which was a 100 per cent. export oriented unit had claimed deduction u/s 80HHC of the Act on the total profit which was derived by it. The assessee had not included the sale of scrap amounting to Rs. 25,30,378 which was generated in the manufacturing process in India in the total turnover for the purposes of arriving at the profit from exports. The assessee had sold the scrap in India which, according to the Assessing Officer, constituted a local sale, therefore, the assessee was not entitled to deduction of the entire net profit and the deduction was to be calculated by adopting the formula:

Business profits x

Export turnover

Total turnover

5. The export turnover is the numerator whereas the total turnover is the denominator in the above formula.

6. The effect of the aforesaid formula was that the deduction u/s 80HHC of the Act which was claimed by the assessee at Rs. 26,81,794 was restricted to Rs. 22,41,380 and disallowance of Rs. 4,40,414 was made. The appeal filed by the assessee was accepted by the Commissioner of income tax (Appeals), Ludhiana (for short "the CIT(A)"). Aggrieved by the order of the Commissioner of income tax (Appeals), the Revenue filed an appeal and the same was dismissed by the Tribunal. The Tribunal noticed that the export turnover and the total turnover of the assessee were identical except for the sale of scrap which was only incidental to the activity of manufacture and export of bicycle parts and, therefore, would not constitute total turnover as the assessee was not dealing in purchase/sale of scrap.

7. We have heard learned counsel for the parties and perused the record.

8. Learned counsel for the Revenue submitted that, according to the provisions of 80HHC of the Act read with the Explanation thereto, the Assessing Officer had rightly disallowed the claim partially by taking the sale of scrap forming part of the total turnover of the respondent-assessee and thereafter applying the formula noticed above. Learned counsel for the Revenue placed reliance upon the judgment of the Karnataka High Court in CIT v. Motor Industries Co. Ltd. [2010] 326 ITR 358 (Karn) to buttress his submission. Support was also gathered from the decision of the Kerala High Court in Commissioner of Income Tax Vs. Kar Mobiles Ltd., I. T. A. No. 773 of 2009, decided on January 15, 2010.

9. On the other hand, controverting the submission made by the learned counsel for the Revenue, learned counsel for the assessee laid stress on the judgments in CIT v. Madras Motors Ltd./M. M. Forgings Ltd. [2002] 257 ITR 60 (Mad), The Commissioner of Income Tax, Tamilnadu-I, Madras Vs. Wheels India Limited, , The Commissioner of Income Tax Vs. Sundaram Clayton Ltd.,), Commissioner of Income Tax Vs. Shiva Distilleries Ltd., Commissioner of Income Tax - I Vs. Ashok Leyland Ltd., CIT v. Punjab Stainless Steel Ind. [2007] 162 Taxman 9 (Delhi), Commissioner of Income Tax, Coimbatore Vs. Lakshmi Machine Works, and Commissioner of Income Tax Vs. Sudarshan Chemicals Industries Ltd., Rathi Engineering Works and Klockner Windsor (I) Ltd., Support was also sought from the decisions of this court in I. T. A. No. 362 of 2004 decided on October 29, 2009 (CIT v. Porrits and Spencer (A) Ltd. and Commissioner of Income Tax Vs. Vardhman Polytex Ltd.,

10. In order to effectively resolve the controversy, it would be advantageous to refer to certain provisions of the statute. Section 80HHC(3) relevant for this appeal, as it existed then, reads thus:

80HHC. Deduction in respect of profits retained for export business.-...

(3) For the purposes of sub-section (1), profits derived from the export of goods or merchandise out of India shall be -

(a) in a case where the business carried on by the assessee consists exclusively of the export out of India of the goods or merchandise to which this section applies, the profits of the business as computed under the head "Profits and gains of business or profession";

(b) in a case where the business carried on by the assessee does not consist exclusively of the export out of India of the goods or merchandise to which this section applies, the amount which bears to the profits of the business (as computed under the head "Profits and gains of business or profession") the same proportion as the export turnover bears to the total turnover of the business carried on by the assessee.

11. "Export turnover" has been defined in Explanation (b) to section 80HHC whereas Explanation (ba) assigns meaning to total turnover. They read thus:

(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.

12. "Export turnover" means the amount received in India or brought into India in convertible foreign exchange on account of sale proceeds of any goods or merchandise which are exported out of India. However, it does not include freight or insurance. Total turnover has been described in negative form so as to exclude freight or insurance. A conjoint reading of both the clauses leads to one conclusion that they include anything which has nexus with the sale proceeds. In other words, they exclude everything which has no nexus with the sale proceeds.

13. Having examined the provision relating to "export turnover" and "total turnover", it is apt to refer to the judicial enunciation on the point and interpretation placed by various pronouncements.

(i) The Division Bench of the Madras High Court in Madras Motors Ltd.'s case [2002] 257 ITR 60 was seized of the matter relating to two deductions, i.e., one u/s 80HH and the other u/s 80HHC of the Act. In so far as the claim of the assessee in respect of deduction u/s 80HH is concerned, it need not be referred to as the same is not relevant for purposes of the present case. However, reference is made to controversy relating to deduction u/s 80HHC of the Act. The assessee was an export oriented company which was manufacturing forgings and derived income from interest receipt, modvat credits and international price rationalisation. The assessee had sold its forgings in India and earned income from local sales and also sold motorcycles, motorcycles spare parts and television sets. It was held that the assessee in addition to export oriented business of forgings had other business also and the assessee was earning income from that other business. It was held that the total turnover should not be the turnover relating to the other business of sale of motorcycles, spare parts and television sets so as to inflate the total turnover artificially in order to reduce the benefit to which the assessee is entitled.

(ii) Following this judgment, in Commissioner of Income Tax Vs. Shiva Distilleries Ltd., it was held by the Madras High Court that excise duty and sales tax would not form part of total turnover. Besides this, the scrap and waste material which was not relatable to the export business of the assessee was held to be excluded from business profit for the purpose of calculation of deduction u/s 80HHC of the

Act. Guarantee commission and royalty was also held to be excluded from business profit for determining the benefit of deduction u/s 80HHC of the Act. Similar view was reiterated in Commissioner of Income Tax - I Vs. Ashok Leyland Ltd.,

(iii) Excise duty and sales tax were held not to be includible in total turnover in The Commissioner of Income Tax, Tamilnadu-I, Madras Vs. Wheels India Limited, In The Commissioner of Income Tax Vs. Sundaram Clayton Ltd., following its earlier judgments in (2002) 257 ITR 60 and The Commissioner of Income Tax, Tamilnadu-I, Madras Vs. Wheels India Limited, it was recorded that for computing deduction u/s 80HHC, sales tax, excise duty, commission and miscellaneous income shall not form part of total turnover.

(iv) The Delhi High Court in Punjab Stainless Steel Ind.'s case [2007] 162 Taxman 9 (Delhi), while referring to whether the sale of scrap generated during the manufacture of goods which were entirely for export, affirmed the view of the Tribunal by holding that it was not incidental to the export activity and could not be treated to be business income and not includible for purposes of computation for deduction u/s 80HHC.

(v) The issue before the Bombay High Court in Commissioner of Income Tax Vs. Sudarshan Chemicals Industries Ltd., Rathi Engineering Works and Klockner Windsor (I) Ltd., was as to whether excise duty and sales tax could be included in the total turnover so as to increase the dominator in the formula for ascertaining the actual deduction admissible to the assessee u/s 80HHC on export turnover. It was observed thus:

Under section 80HHC, the Legislature intends that the profits from exports should not be taxed. For this purpose, a formula has been introduced whereby if the business is of composite nature then the proportionate profit relatable to the export business is to be found out by multiplying the profits of a business by the export turnover and dividing the product by the total turnover. This formula finds place in section 80HHC(3) as it stood at the relevant time. Under clause (b) of the Explanation to section 80HHC, export turnover is defined to mean sale proceeds received in India by the assessee in foreign exchange. Under the said definition, export turnover is defined to mean the sale proceeds of any goods which are exported out of India but which will not include freight or insurance. Clause (ba) defines total turnover to exclude freight or insurance. This clause (ba) explains the turnover in a negative manner so as to exclude freight or insurance. Therefore, a combined reading of the above two clauses shows that they include anything which has nexus with the sale proceeds. Correspondingly, they show that they exclude everything which has no nexus with the sale proceeds. Further, the meaning of export turnover in clause (b) of the Explanation to section 80HHC, therefore, clearly shows that export turnover did not include excise duty and sales tax. The export turnover is the numerator in the above formula whereas the total turnover is the denominator. The above formula has been prescribed to arrive at the profits from exports. In the

circumstances, the above two items, namely, sales tax and excise duty, cannot form part of the total turnover. In fact, if the denominator was to include the above two items and if the numerator excluded the above two items then the formula would become unworkable. In the circumstances, we are of the view that in order to ascertain the export profits, the above two items cannot be introduced to inflate the total turnover artificially in order to reduce the benefit which an assessee is entitled to. Ultimately, the object of section 80HHC is required to be kept in mind in order to encourage exports. The Legislature has applied the above formula in order to find out the profits derived from the exports. In this connection, section 80HHC(1) may also be noticed. u/s 80HHC(1), it is, inter alia, provided that where an assessee is engaged in the business of exports of any goods, there shall 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. In other words, in computing the total income of such an assessee, profits derived by the assessee from the exports are deductible. The above expression, namely, "profits derived from exports" also finds place in section 80HHC(3)(a). It says that where the export is of goods, 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. In fact, the earlier section 80HHC(3) consisted of two parts, namely, whether the assessee carried on a business as 100 per cent. exporter and, secondly, whether the assessee carried on a composite business. In the latter case, it was provided that the profits derived from exports shall be the amount which bears to the profits of the business as computed under the head "Profits and gains of business", the same proportion as the export turnover to the total turnover. The emphasis is on the words "profits derived from the exports". Therefore, weightage must be given to such profits. Such profits cannot be reduced artificially by including statutory levies in the denominator, namely, total turnover. Therefore, the turnover should be restricted to such receipts which have an element of profit in it. It is only the actual sale price which is relevant. Anything charged by the assessee by way of excise duty and sales tax cannot be taken into account as they do not have any element of profit. Even according to the accounting principles, such levies do not form part of the profit and loss account. In fact, they are shown as liability in the balancesheet. In the circumstances, the above two items cannot be included in the total turnover. We prefer this interpretation as it advances the object sought to be achieved by the Legislature. Lastly, we are of the view that sales tax and excise duties are levied under the separate enactments which have different objects. We are concerned with section 80HHC which is separate code by itself. Hence, the general definition of the word "turnover" or the case law dealing with the said definition under the Sales Tax Act which is a State levy, cannot be imported into section 80HHC of the income tax Act.

(vi) The Apex Court in Commissioner of Income Tax, Coimbatore Vs. Lakshmi Machine Works, interpreting "total turnover" had laid down that excise duty,

sales tax, commission received, interest, etc., do not emanate from the "turnover" and shall not form part of "total turnover" as these do not involve any element of sale and do not partake of the character of turnover. (vii) This court in I. T. A. No. 362 of 2004, decided on October 29, 2009, in CIT v. Porrits and Spencer (A) Ltd. had dismissed the appeal relating to the issue of sale of scrap keeping in view the low quantum of tax effect of Rs. 3,797 involved therein in the light of finding of fact recorded by the Tribunal therein. In Commissioner of Income Tax Vs. Vardhman Polytex Ltd., , this court held that excise duty and sales tax shall not be includible in total turnover for purposes of section 80HHC of the Act.

14. Reference may now be made to the judgments relied upon by the Revenue. The Karnataka High Court, interpreting the expressions "export turnover" and "total turnover" with the literal meaning, concluded that the sale of scrap as a result of manufacturing of item which was exported had resulted in income to the assessee. It could not be excluded from total turnover for the purposes of determining actual deduction admissible to the assessee u/s 80HHC of the Act. The relevant observations read thus:

The learned senior counsel appearing for the assessee relying upon the judgment of the Madras High Court reported in the case of Commissioner of Income Tax - I Vs. Ashok Leyland Ltd., , contends that income from scrap sale cannot be treated as part of turnover for the purpose computing the deduction under sections 80HHC and 80HHE. He further relied upon the judgment of the Madras High Court in Commissioner of Income Tax Vs. Shiva Distilleries Ltd., Relying upon these two decisions, he contends that if the value of the scrap is taken into consideration under the head total turnover the cost of the raw materials would artificially go up. According to him, while computing the total turnover, the value of the scrap received by the assessee cannot be taken into consideration since it is not an export sale. He further contends that the Madras High Court in (2002) 257 ITR 60 has fairly held that for the purpose of computing section 80HHC, only the turnover relating to export business of the assessee shall be taken into account and not the turnover relating to the other business of the assessee. Relying upon these two decisions, he requests the court to answer the question of law against the Revenue and in favour of the assessee.

Having heard the counsel for the parties, we have to consider whether the value received by the assessee by selling scrap in a domestic market has to be included towards its total turnover while calculating deduction u/s 80HHC. By looking into the definition of export turnover and the total turnover as defined u/s 80HHC(4C) Explanation (b) and (ba), it is clear they are different and distinct turnovers. The export turnover includes only the value received by selling the products of the assessee from out of country. But total turnover includes the turnover of the assessee which is inclusive of export turnover and also the domestic turnover. Therefore, we are of the view that in view of the distinct definition clause of export turnover and total turnover, while computing the total

turnover for the purpose of section 80HHC, the Assessing Officer is required to consider the value received by sale of the scrap also, as the same cannot be excluded as the sale of scrap amounts to a turnover in a domestic market.

We have carefully considered the judgments relied upon by the learned senior counsel appearing for the assessee. In the two judgments relied upon by him, the Madras High Court did not actually consider the definition of export turnover and total turnover while computing the sale of scrap. Without considering the provision of law properly, the Madras High Court has taken a view that the value of the scrap received by the assessee cannot be computed for the purpose of sections 80HHC and 80HHE, under the sales total turnover. Therefore, we are not in a position to accept the decision relied upon by the learned counsel for the assessee as the Madras High Court did not consider the definition of export turnover and total turnover as defined u/s 80HHC(4C), Explanation (b) and (ba).

In the circumstances, we have to answer the question of law in this appeal in favour of the Revenue and against the assessee.

15. The Kerala High Court taking a similar view in Commissioner of Income Tax Vs. Kar Mobiles Ltd., had observed:

...On the other hand, the finding of the Tribunal and the lower authorities is that scrap is generated in the course of manufacture of goods and scrap is systematically sold by the assessee forming part of its business. So much so, in our view, the income from sale of scrap is part of the business profit and its sales turnover forms part of total turnover which will constitute denominator for determination of eligible deduction of export profit.

16. Having examined the provisions of section 80HHC and the judgments noted above, we are of the opinion that the excise duty, sales tax, interest or commission received cannot be characterized as turnover and, therefore, shall not form part of "total turnover". However, the sale of scrap would be on a different pedestal. Once an element of sale is involved in the case of scrap, it would fall in a separate category and cannot be excluded from "total turnover" which shall increase the denominator of the formula for determining the extent of the benefit admissible to an assessee u/s 80HHC of the Act. In other words, the sale of scrap in the domestic market shall form part of the total turnover whereas excise duty, sales tax, commission and miscellaneous income shall not be part of the total turnover for calculating the benefit of deduction u/s 80HHC of the Act. Accordingly, we express our concurrence with the view expressed by the Karnataka and the Kerala High Courts and dissent with the judgments taking the contrary view of the Madras and the Delhi High Courts.

17. It is not disputed that in the case in hand the scrap which had resulted from the manufacturing of the item exported, was sold in the local market in India. Once that was so, the assessee was not justified in excluding the same from calculating the total turnover of the registered firm. Accordingly, the appeals are allowed and the substantial questions of law are answered in favour of the

Revenue.