

(1999) 11 KL CK 0028

In the High Court Of Kerala

Case No : Income-tax Reference No. 68 of 1997

Commissioner of Income Tax

APPELLANT

Vs

C.W.S. (India) Ltd.

RESPONDENT

Date of Decision : 27-11-1999

Acts Referred:

Income Tax Act, 1961 — Section 30, 31, 32, 33, 34
Income Tax Rules, 1962 — Rule 8

Citation : (2000) 158 CTR 529 : (2000) 246 ITR 278

Hon'ble Judges : Arijit Pasayat, C.J.;K.S. Radhakrishnan, J

Bench : Division Bench

Advocate : P.K.R. Menon and George K. George, for the Appellant; C.N. Ramachandran Nair, for the Respondent

Judgement

Arijit Pasayat, C.J.—Accepting the prayer in terms of Section 256(1) of the Income Tax Act, 1961 (in short, "the Act"), made by the Revenue, the Income Tax Appellate Tribunal, Cochin Bench (in short, "the Tribunal"), has referred the following question for the opinion of this court :

"Whether, on the facts and in the circumstances of the case, the asses-see is entitled to get deduction u/s 80HHC of the Income Tax Act, 1961, before applying Rule 8(1) of the Income Tax Rules, 1962 ?"

2. The factual position is undisputed and needs to be noted in brief. The assessee is a company in which the public are substantially interested. It is engaged mainly in the business of cultivation, manufacture and sale of tea. For the assessment year 1985-86, the assessee claimed deduction u/s 80HHC of the Act in respect of the entire export business of tea manufactured in its own estate, As only 40 per cent. of such turnover has to be taken for Income Tax purposes, deduction u/s 80HHC in respect of the aforesaid turnover was restricted to 40 per cent. of such turnover by the Assessing Officer. In appeal, the Commissioner of Income Tax (Appeals) (in short, "the CIT(A)") upheld the assessment. The matter was carried by the assessee before the Tribunal, which held that the

asses-see was entitled to get deduction u/s 80HHC before applying Rule 8(1) of the Income Tax Rules, 1962 (in short, "the Rules"). Reliance was placed in the decision of the Madras High Court in Commissioner of Agricultural Income Tax and Another Vs. Periakaramalai Tea and Produce Co. Ltd. and Others, . As indicated above, the Revenue moved for a reference which has been accepted.

3. In support of the reference application, learned counsel for the Revenue submitted "that what is to be considered as profits of business for the purpose of computing" deduction is income liable to tax under the Act. The decision of Madras High Court, as referred to above, was in respect of the Agricultural Income Tax Act and has no relevance to the case of the assessee. Learned counsel for the assessee, on the other hand, submitted that as per Rule 8(1) of the Rules, the entire income from sale of tea grown and manufactured by the assessee should be computed as if income derived from business and 40 per cent. of such income shall be deemed to be income liable to Income Tax. The dispute before the Tribunal was whether in computing composite income derived from sale of tea grown and manufactured by the assessee, allowance u/s 80HHC should be first computed and thereafter, income so computed is to be apportioned under Rule 8 of the Rules. Though the decision of the Madras High Court was in respect of deduction u/s 80-I, the decision had full application to deduction u/s 80HHC, held the Tribunal.

4. For resolution of the dispute between the parties, it is necessary to take note of Section 80HHC and Rule 8 so far as relevant. Section 80HHC of the Act reads thus :

"(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 equal to the aggregate of--

(a) four per cent. of the net foreign exchange realisation ; and

(b) fifty per cent. of so much of the profits derived by the assessee from the export of such goods or merchandise as exceeds the amount referred to in Clause (a) :

Provided that the deduction under this sub-section shall not exceed the profits derived by the assessee from the export of such goods or merchandise :

Provided further that an amount equal to the amount of the deduction claimed under this sub-section is debited to the profit and loss account of the previous year in respect of which the deduction is to be allowed and credited to a reserve account to be utilised for the purposes of the business of the assessee . . .

(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." Rule 8 of the Rules reads as follows :

8. Income from the manufacture of tea.--(1) Income derived from the sale of tea grown and manufactured by the seller in India shall be computed as if it were income derived from business, and forty per cent. of such income shall be deemed to be income liable to tax.

(2) In computing such income an allowance shall be made in respect of the cost of planting bushes in replacement of bushes that have died or become permanently useless in an area already planted, if such area has not previously been abandoned, and for the purpose of determining such cost, no deduction shall be made in respect of the amount of any subsidy which, under the provisions of Clause (30) of Section 10, is not includible in the total income."

5. Rule 8 refers to computation of the income derived from the sale of tea grown and manufactured by the seller in India as if it were income derived from business and 40 per cent. of such income is to be deemed to be income liable to tax. In other words, there has to be computation of income in accordance with the provisions of the Act. As a necessary corollary, deduction is allowable including what is covered under Chapter VI-A (deductions to be made in computing the total income). It is to be noted that Chapter VI-A was inserted by the Finance Act, 1965, with effect from April 1, 1965. Section 80HHC is a part of Chapter VI-A. We do not find any substance in the plea of learned counsel for the Revenue that only deductions contained in Chapter IV of the Act, more particularly those contained in Sections 30 to 43D are to be reckoned for purpose of computation. Deduction from income for the purpose of computing taxability of income has to be done not only taking into account the provisions of Sections 30 to 40D, but also taking into consideration deductions permissible under Chapter VI-A of the Act. As stated above, Section 80HHC is a part of Chapter VI-A. Section 80HHC refers to computation of the total income of the assessee. Rule 8 creates a legal fiction. 40 per cent. tax deemed to be income liable to tax under Rule 8 is chargeable income. Inevitable conclusion, therefore, is before applying the 40 per cent. rule, income should be first computed in accordance with the provisions of the Act, i.e., after allowing deductions including those encompassed by Chapter VI-A of the Act. In interpreting the provision, the court has to ascertain for what purpose the fiction is created and after ascertaining this, it has to assume all those facts and consequences which are incidental or

inevitable corollaries for giving effect to such fiction. When a legal fiction is created, for what purpose, one is led to ask at once, is it so created ? (see *State of Travancore-cochin and Others Vs. Shanmugha Vilas Cashew Nut Factory and Others*,). After ascertaining the purpose, full effect must be given to the statutory fiction and it should be carried to its logical conclusion and to that end, it would be proper and even necessary to assume all those facts on which alone the fiction can operate (see *Commissioner of Income Tax, Delhi Vs. S. Teja Singh*,). In an oft-quoted passage, Lord Asquith stated (page 413) : "If you are bidden to treat an imaginary state of affairs as real, you must surely, unless prohibited from doing so, also imagine as real the consequences and incidents which, if the putative state of affairs had in fact existed, must inevitably have flowed from or accompanied it ... The statute says that you must imagine a certain state of affairs ; it does not say that having done so, you must cause or permit your imagination to boggle when it comes to the inevitable corollaries of that state of affairs" (see *East End Dwellinys Co. Ltd. v. Finsbury Borough Council* [1951] 2 All ER 587). It is well settled that a legal fiction is to be limited to the purposes for which it was created and should not be extended beyond the language of the section by which it is created. It is to be noted that Rule 8 deals with two types of income, i.e., agricultural income and non-agricultural income at the ratio of 60 : 40 of the total income. After computing the total income, the same has to be bifurcated in the above manner. Therefore, the total income would necessarily mean the net income and not gross income. Before the charging section is given effect, taxable income must accrue and while computing the total income, all expenditure and other deductions and allowances must be taken into account before the net income is computed. A great emphasis is laid by learned counsel for the Revenue on *Commissioner of Income Tax, Madras Vs. R.M. Chidambaram Pillai and Others*, . The decision has no application to the facts of the present case, as the same related to the method of taxing salary paid to a partner by a firm which grows and sells lea. With reference to Rule 24 of the Indian Income tax Rules, 1922, it was held that exemption was to be granted to the extent of 60 per cent. thereof representing agricultural income and tax was to be levied only on 40 per cent. The manner of compulation was not in issue, which is involved in the case at hand.

6. The question is answered in the affirmative, in favour of the assessee and against the Revenue.