(2001) 11 KL CK 0028

In the High Court Of Kerala

Case No : Income Tax A. No. 369 of 1993 & Income Tax A. No. 60 of 2001 and Income Tax Reference No. 111 of 1997

Commissioner of Income Tax APPELLANT

Vs

Jose Thomas RESPONDENT

Date of Decision : 30-11-2001

Acts Referred:
Income Tax Act, 1961 — Section 28, 288(2), 80HHC, 80HHC(1)

Citation : (2001) 11 KL CK 0028

Hon'ble Judges : P.K. Balasubramanyan, J;C.N. Ramachandran Nair, J

Bench : Division Bench

Advocate : P.K. Raveendranatha Menon and George K. George, for the Appellant; V.J. Mathew, Public Prosecutor Rajesh and Sabu P. Joseph, for the Respondent

Judgement

C.N. Ramachandran Nair, J.—The assessee is an individual engaged in various business activities such as processing and export of sea foods, in the construction and sale of flats, shipping agency business and is also deriving income in the form of interest, dividend, etc. The assessments involved in these two cases are for the assessment years 1990-91 and 1991-92. There is only one these involved in ITA No. 60 of 2001 which is for the assessment year 1990-91 and the substantial question formulated by us for decision in the appeal is the following:

Whether, on the facts and in the circumstances of the case, the interest income and dividend on SBI Magnum units totalling to Rs. 11,62,980/- is entitled to be assessed under the head "business income" and eligible for deduction u/s 80HHC of the Income Tax Act?

2. In the Income Tax Reference, ITR No. 111 of 1997, the Tribunal has referred the following four questions for decision of this Court:

1. Whether on the facts and in the circumstances of the case, the Appellate

Tribunal was right in holding that interest received by the assessee from fixed deposit and Magnum deposit with the bank is eligible for deduction u/s 80HHC?

2. Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that the words "totalling turnover" for Section 80HHC can only have reference to the turnover by way of sales and cannot take in its stride the gross receipts received?

3. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that for the purpose of deduction u/s 80HHC the turnover of the construction division should be adopted at Rs. 61,26,097/- being the difference between gross amount of Rs. 4,65,50,906/- received from the owners of the flats and the corresponding expenses thereto as against Rs. 4,65,50,906/- being the gross amount received and adopted in the assessment?

4. Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that in working out the proportionate income eligible for deduction u/s 80HHC allowable on the export income the turnover of the business under Explanation (c) to Section 80HHC(1) should include only net receipts after allowing construction expenses as against gross amounts received from flat owners and adopted in the assessment?

The sole question in the appeal case for the assessment year 1990-91 and the first question in the Reference case for the assessment year 1991-92 relate to the same matter, and the question is whether the interest income received by the assessee from fixed deposits in the bank and the dividend received from the SBI Magnum constitute "business income" for the purpose of computation of eligible deduction on export profits u/s 80HHC of the Income Tax Act.

3. The balance three questions referred by the Tribunal to this Court for the assessment year 1991-92 are on the manner of computation and the extent of relief available to the assessee as a deduction on export profits provided u/s 80HHC of the Income Tax Act. In order to decide the controversy we feel that questions deserve to be redrafted to reflect the issues arising in the case. However, prior to redrafting the questions, we find it necessary to state the facts, the claim made by the assessee, the way the authorities approached and decided the issues, and the way the issues arise in the case before us.

4. The various figures available are the following:

Total adjusted income for computation of relief u/s 80HHC as per the assessee''s statement Rs. 60,46,782 Total turnover of sea foods division as per the assessee''s statement Rs.1,88,23,993 Export turnover (assessee has only sea foods export) as per the assessee''s accounts Rs. 1,87,95,309 Gross profit in sea foods business as per assessee''s account Rs. 23,88,067 Gross profit from shipping business as per assessee''s accounts Rs. 14,99,048 Gross profit from construction division, contract fee-Choice garden Rs. 61,26,097 Income from building management Rs. 72,700 Other sources Rs. 11,74,708 Income from

Software Rs. 1,28,400 --------------- Total Rs.1,13,88,720 ----------------

Total turnover adopted by the assessee without including the amount of Rs. 4,04,24,809/- being the cost of flats constructed and given to customers for the purpose of computation of eligible export profit u/s 80HHC(3) of the Income Tax Act Rs. 2,66,50,238.

The assessee''s manner of computation for deduction of export profit u/s 80HHC:

= Export turnover x net income from business --------------- total turnover (excluding cost of flats) = 18795309 x 6046782=Rs. 42,64,590/- --------- 26620238

Accordingly the assessee has claimed deduction u/s 80HHC for an amount of Rs. 42,64,590/- towards eligible deduction of export profit from the sea foods export as against gross profit from sea foods business computed by the assessee at Rs. 23,88,067/-. The assessing officer was of the view that the assessee cannot claim export profit over the gross profit from that line of business. Moreover, the assessing officer also felt that certain items of income, including interest from bank deposits and dividend from SBI Magnum do not come within description of "business income" and therefore the assessee cannot claim deduction on export profit u/s 80HHC of the act in respect of those items of income. Accordingly, the total adjusted income computed by the assessee was reduced by those items of income including interest income on bank deposits and dividend income from SBI Magnum for the purpose of computation of eligible deduction u/s 80HHC of the Act. The assessing officer redetermined the total adjusted income at Rs. 55,98,671/-. The assessing officer worked out the eligible deduction on export profit u/s 80HHC of the Act by taking the figures applicable to the sea food division because the assessee has exports only in sea-foods. First he determined the net profit from sea foods in applying the following formula:

Net Profit from sea food division = Net adjusted business income x Gross profit from sea food division --------------------------- Gross profit from business = 5598671 x 2388067 = Rs. 13,35,236/-. ------- 1001321

Thereafter the assessing officer worked out Export profit for deduction u/s 80HHC by applying the following formula:

Eligible deduction u/s 80HHC

= Net adjusted income determined in sea food business x Export turnover -- Total turnover is sea food =1335236 x 187945509=Rs. 13,33,315/-. -------- 18823993

Accordingly, the assessing officer disallowed the claim of deduction on export profit u/s 80HHC in excess of what is computed as above. The assessing officer also in the course of computation of adjusted total income excluded a few items of income including interest on fixed deposits and dividend from SBI Magnum. The assessee''s appeal on the computation of relief u/s 80HHC was not successful before the Commissioner of Income Tax (Appeals). However, on Second Appeal filed by the assessee, the Tribunal reversed the order of the Commissioner of Income Tax (Appeals) and allowed the assessee''s claim. While deciding the appeal by the department, the Tribunal held as follows:

1. The assessing officer''s manner of working out of relief u/s 80HHC is incorrect because the assessing officer confined his working out only to the sea foods division of the assessee on the ground that the assessee has export only in sea foods.

2. The assessing officer''s finding that the amount received from the owners of flats on construction and sale of flats by the assessee constitutes ''total turnover'' is wrong and therefore the amount received by the assessee in the form of gross income from real estate business only can be treated as turnover. This has resulted in exclusion of turnover of Rs. 4,04,24,809/- received by the assessee towards cost of flats constructed and given to customers.

3. The computation of relief u/s 80HHC by the assessee is correct.

Therefore the first question is whether the method adopted by the assessee or the assessing officer is the correct method of computation of relief u/s 80HHC(3) of the Income Tax Act. If the assessee''s method is the correct one, then the second issue is whether the exclusion of the amount received by the assessee for the construction and delivery of flats to the customers from "total turnover" for the purpose of computation of relief u/s 80HHC of the Act is correct. In order to consider these questions, we have to reframe the questions as follows:

1. Whether the Tribunal was justified in holding that the method and manner of computation of eligible deduction u/s 80HHC(3) of the Income Tax Act by the assessing officer is not correct?

2. If the answer to the above questions in the affirmative, was the Tribunal justified in upholding the method adopted by the assessee for the computation of relief u/s 80HHC(3) and in further holding that the amount received by the assessee from the customers for construction and delivery of flats in the land owned by the assessee is not part of "total turnover" for the purpose of computation of eligible deduction u/s 80HHC of the Act?

We therefore proceed to answer the reference on these questions reframed by us and also on the common question referred to in paragraphs 1 and 2.

5. In order to appreciate the issues, it is necessary to refer to the relevant portion of Section 80HHC which is extracted hereunder:

Section 80HHC(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:

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(3) For the purpose of Sub-section (1) profits derived from the export of goods or merchandise out of India shall be 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.

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(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 on the basis of the amount of export turnover.

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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, and any rules made thereunder:

(b) "export turnover" means the sale proceeds receivable 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 define din the Customs Act, 1962 (52 of 1962)l

(c) total turnover shall not include any sum referred to in Clauses (iiia), (iiib) and (iiic) of Section 28.

There is no dispute on the facts that the assessee is engaged in export of only sea foods and the assessee has various other items of income under the same head "business income", and is also deriving income from "other sources". Therefore the computation of deduction of eligible profit in respect of export business has to be made only under Sub-section (3) of Section 80HHC of the Act.

6. As already stated, the first question is whether the income in the form of dividend from SBI Magnum and interest income from bank deposits would constitute "business income" of the assessee for the purpose of computation of deduction u/s 80HHC. We have already taken a deduction in ITR No. 29 of 1998 by judgment dated 13.11.2001 to the effect that interest income on bank deposits is only income from "other sources" and does not constitute business income for the purpose of computation of the relief u/s 80HHC of the Income Tax

Act. Similar is the view taken by this Court in Traco Cable Company Ltd. Vs. Commissioner of Income Tax, and in Collis Lines P. Ltd. v. C.I.T. 1351 ITR 390. The Tribunal on the other hand has stated that the bank deposits and S.B.I. Magnum Certificates were offered as security for availing packing credit facility and therefore there is connection between the bank deposits and the business activities of the assessee. In that view of the matter, the Tribunal held that the interest earned by the assessee on such bank deposits would constitute business income. We are unable to accept this logic of the Tribunal. The income generated from collateral security does not constitute business income unless the assessee is engaged in this case in the activity of advancing money and receiving income in the form of interest. We are afraid if the assessee had offered agricultural land as collateral security for business loan, the Tribunal probably would have held that agricultural income arising from such land would also constitute "business income" for the purpose of computation of eligible profit u/s 80HHC of the Act. Similar is the nature of income in the form of dividend from SBI Magnum. Therefore we are of the view that the Tribunal went wrong in reversing the exclusion of these items from business income made by the assessing officer, and affirmed by the Commissioner of Income Tax (Appeals). Following our decision in ITR No. 29 of 1998 and the decision of this Court in Collis Lines''s case and Traco Cables Company''s case, we answer the sole question in I.T.A. No. 60 of 2001 and the first question in ITR No. 111 of 1997 in favour of the revenue and against the assessee. Accordingly we reverse the order of the Tribunal in both the cases on this point.

7. With regard to computation of eligible deduction of export profit from business, we feel that the method adopted by the assessing officer is not correct, because it is not strictly in confirmity with Sub-section (3) of Section 80HHC of the Act. The assessee is only engaged in export of sea foods, and the assessee''s profit in sea foods, turnover of export sales, and total turnover of sea foods division are also available on record. After all the method of computation u/s 80HHC(3) is only to find out the profit attributable to export business in a case where the assessee has local as well as export business. Therefore even though the assessee has several lines of business under his various divisions, there was no necessity to reckon the figures in all these business activities, if it was possible for the assessing officer to work out export profit otherwise which in fact he has done. We are fully in agreement with the view expressed by the assessing officer that whatever be the formula adopted for computation of export profit under Sub-section (3) of Section 80HHC, the same should not involve in the transfer of profit from local business to export business. In other words, the assessee''s working out of export profit at Rs. 42,64,590/- which is obviously more than the gross profit from the sea foods division is patently untenable. However, we feel the assessing officer did not strictly comply with the formula provided u/s 80HHC(3) of the Act for the purpose of computation of eligible profit from export business. This is because the assessing officer has applied the formula:

= Export turnover x Proportionate adjusted income from sea foods division ---------------- Total turnover of sea foods division

On the other hand, Section 80HHC(C) provides for the following formula:

= Profit as computed under the head "business income" x Export turnover -- Total turnover

As already mentioned, the only dispute with regard to business income computed under the provisions of the act is only on the exclusion of two items of income, namely, interest and dividend which we have confirmed. There is also no dispute on the export turnover which is adopted by the assessing officer from the assessee''s accounts. However, there is a serious dispute on the "total turnover" as computed by the assessing officer and as offered by the assessee. Since the assessing officer has adopted a different method of computation, his finding on the total turnover did not have much significance. However, since we have found that the assessing officer has not strictly followed Section 80HHC(3) in the computation of eligible deduction, it has become necessary for us to adjudicate on the correctness of the finding of the Tribunal with regard to meaning of "total turnover". In this regard the only dispute is whether the amount received by the assessee from the flat owners towards cost of construction of flats is to be treated as turnover. The amount involved is Rs. 4,04,24,809/-, which is completely excluded by the assessee while adopting total turnover" for the purpose of computation of eligible deduction on export profit. The assessee has only taken the gross profit of the construction division as "turnover" and the same is upheld by the Tribunal. We have no doubt in our mind that the income from the construction division is not the "turnover" and therefore the finding of the Tribunal is patently untenable. The question to be addressed is what turnover yielded this gross profit to the assessee. In that view of the matter, we feel that the turnover to be adopted is the entire receipt from the customers for the development of the land and construction and sale of flats. The assessee has also produced an agreement before the Tribunal, and the Tribunal has referred to the clauses in the agreement, which is part of a typical land development agreement whereunder the assessee as the owner of land agrees to sell undivided right in the land and by separate agreement undertakes to construct and deliver the flats to the customers. The assessing officer and the Commissioner of income tax (Appeals) found, and the assessee has no case to the contrary, that the assessee as a contractor has purchased bulk materials on his own account and constructed the seven storied building with 82 flats and sold the flats to the purchasers. Therefore the assessee is the purchaser in his own account, and the construction is carried out at assessee''s expenses. It was not the case of the assessee that he was acting as agent for construction of flats and he was receiving commission or other service charges from the customers along with reimbursement of actual cost. The assessee obviously made huge margin in the construction and sale of flats and the same is evident from the fact that the assessee has earned a gross profit of Rs. 61,26,097/- from the construction division. The learned counsel appearing for the assessee contended that the amount received from the flat owners towards cost of lats should not be treated as turnover of the assessee and in any case, according to him, the assessee has not received the entire amount of Rs. 4,04,24,809/- in the relevant previous year. So much so, the contention of the learned counsel is that the amount does not form part of turnover at least for this year. As already observed above, it is a question of finding out the turnover from which the assessee has derived the gross profit of Rs. 61,26,097/- under construction division. Since the assessee has made margins on the construction of the flats, the sale price of the flats has to be the turnover of the assessee. If the assessee is to account profit in the subsequent years from the construction and sale of flats, then certainly the collections in subsequent years towards cost of the flats should not be treated as part of turnover of this year. However, this does not appear to be the position, and such a question was not raised before the lower authorities. If the profit for the construction and sale of flats is fully accounted in this year, then the entire turnover including the amount received towards cost of construction of flats, ie., Rs. 4,04,24,809/- has to be treated as turnover for the purpose of computation of eligible deduction of profit u/s 80HHC(3) of the Act. The Tribunal has elaborately discussed the scope of turnover and gave a finding that the cost of construction does not form part of turnover. In this context, we find that the definition in the Section is not helpful. Therefore the reference to "turnover" as defined in the KGST Act pursuant to the Constitution (46th Amendment) Act has significance. The turnover on works contract defined in Explanation IA(i) to Section 2(xxvii) is as follows:

The turnover in respect of works contract shall be the aggregate amount received or receivable by the dealer for the transfer of goods (whether as goods or in some other form) involved in the execution of such contract.

Therefore we are of the view that the Tribunal committed an error of law in holding that the total turnover for the purpose of computation of eligible deduction u/s 80HHC(3) does not include the cost of flats constructed by the assessee. Accordingly we reverse the order of the Tribunal. However, this does not mean that the computation as done by the assessing officer and as affirmed by the Commissioner of Income Tax (Appeals) is to be upheld as such. As already mentioned, the formula adopted by the assessing officer and confirmed in the first appeal is not strictly in conformity with the formula provided u/s 80HHC of the Act. Therefore we reverse the order of the Tribunal and that of the authorities below and direct the Tribunal to recompute the eligible deduction and if necessary to remand the case to the assessing officer for recomputation by applying the following formula:

Eligible deduction u/s 80HHC

= Income as computed under the head "income from business" after excluding interest income from bank deposits and dividend income from S.B.I. Magnum x Export turnover ----------------------------- Total turnover including Rs. 4,04,24,809/- or such other amount determined by the Tribunal being the cost of construction of flats received by the assessee from the flat owners

In view of the contention raised by the assessee that the entire cost of flats is not turnover of this year, we feel the same requires investigation. The assessee is given liberty to furnish figures of earlier and subsequent years account and prove the total turnover in the construction and sale of flats attributable to the profits accounted in this year.

8. In the result, the Income Tax Appeal No. 60 of 2001 stands allowed by reversing the order of the Income Tax Appellate Tribunal. In the Income Tax Reference No. 111 of 1997, we answer the first question as reframed by us in favour of the revenue and against the assessee and the second question as reframed b us is answered partly in favour of the revenue and partly in favour of the assessee with direction to the Tribunal to work out the relief in the light of our findings and observations above.

