

(2010) 08 KAR CK 0123
In the Karnataka High Court
Case No : IT Appeal No. 28 of 2005

Commissioner of Income Tax

APPELLANT

Vs

Motor Industries Co. Ltd.

RESPONDENT

Date of Decision : 04-08-2010

Acts Referred:

Citation : (2012) 207 TAXMAN 78

Hon'ble Judges : N. Kumar, J;B.V. Nagarathna, J

Bench : Division Bench

Advocate : M.V. Seshachala, for the Appellant; P.J. Pardiwala, for the Respondent

Final Decision : Dismissed

Judgement

N. Kumar, J.—This appeal is by the Revenue, challenging the order passed by the Tribunal which has disallowed the deduction of Rs. 64,75,373/- being the fee received towards developmental work in computing the profits of the business u/s 80HHC of the income tax Act, 1961 (hereinafter referred to as "the Act"). The assessee is public limited company carrying on business of manufacturing and sale of automobile parts like spark plugs, fuel injection equipment etc. For the year 1994-95 the appellant received Rs. 64,75,373/- as fees towards developmental work from M/s. Robert Bosch, Germany. The assessee claimed deduction u/s 80-O of the Act, which was granted. For the purpose of deduction u/s 80HHC of the Act, the Assessing Officer deducted 90% of the above amount applying the provisions of Explanation (baa) to Section 80HHC of the Act. The assessee objected to the said deduction. The assessee contended that the proviso to Explanation (baa) could be applied only to those items which are specifically mentioned therein. The technical service fees received from Bosch was not one of such specified items. Overruling the said objection, the assessing officer held that it is consideration flowing to the assessee for the services rendered by them, and therefore it would fall in the category of "any other receipt of similar nature" and deducted the said amount from profits of the business. Aggrieved by the same, assessee preferred an appeal to the

Commissioner for Income Tax, Appeals were dismissed. Aggrieved by these two orders, the assessee preferred an appeal to the Tribunal. The Tribunal, relying on the judgment of the Cochin Bench of the Tribunal in the case of Asstt. CIT v. Herbal Isolates (P.) Ltd. [2002] 83 ITD 310 and also the judgment of the Bombay High Court in Commissioner of Income Tax, Pune Vs. Hindustan Antibiotics Ltd., held that the said deduction was not warranted. Therefore it set aside the orders and upheld the contention of the assessee. Aggrieved by the same, revenue is in appeal.

2. Learned counsel for the revenue assailing the impugned order, contended that the receipt of Rs. 64,75,373/- fees towards developmental work is not a sale consideration for sale of goods or merchandise by the assessee in the course of export business. Admittedly, the said income is not included in the export turnover. The assessee already had availed the benefit of the said income u/s 80-O of the Act. The said income is in the nature of "charges" as contemplated under clause (i) of Explanation (baa) to 80HHC of the Act. Therefore, as held by the Apex Court in the case of Commissioner, Income Tax, Thiruvananthapuram Vs. K. Ravindranathan Nair, the said amount has to be deducted from the profits of the business. The Tribunal was in error in interfering with the orders passed by the Commissioner as well as the assessing officer and therefore he submits that a case for interference is made out.

3. Per contra, learned Sr. counsel appearing for the assessee contends that the aforesaid amount is earned by the assessee in the course of its export business and it has earned profit to that extent, though the said profit does not arise out of sale of goods or merchandise in the course of export business. It is not included in the export turnover. The benefit u/s 80-O of the Act is availed of as it forms part of an income arising out of the services rendered. The claim for IT Appeal Nos. 806 & 809 to 811 of 2006 on a different basis. Even if it were to be held, there is a double benefit to the assessee, the same is not prohibited under law. Once the assessee has earned that income in the course of his export business, clause (i) of Explanation (baa) is not attracted, it does not fall within one of the categories specifically provided under that provision and therefore the said amount cannot be deducted in computing profits of the business as rightly held by the Tribunal. Therefore, he submits that no case for interference is made out.

4. Therefore, the substantial question of law that arise for our consideration is:--

Whether the income received by the Assessee towards developmental work in the course of its export business which is different from the income arising out of the business of export, out of India of any goods or merchandise, is liable be reduced by 90% as provided under clause (1) of (baa) of Section 80HHC of the Act?

5. The facts are not in dispute. The total turnover of the assessee for the assessment year 1994-95 is Rs. 621,54,85,841/- which includes excise duty and

sales tax. Rs. 61,79,08,068/- is export turnover. The assessee claimed Rs. 67,47,868/- as profits of the business. However, out of the said profits, assessee gave deduction to export incentives, sale of Exim scrips, rent, interest, commission and thereafter the figure arrived at was Rs. 63,72,73,897/-. However, the assessing officer deducted Rs. 64,75,373/- towards consideration received from M/s. Robert Bosche for developmental work and arrived at the profits of the business of Rs. 63,14,46,061/-. This deduction is the bone of contention between the parties.

6. Section 80HHC of the Act provides for deduction in respect of the profits retained for export business. It is not in dispute that the condition precedent for application of this provision is that the assessee must be engaged in the business of export out of India of any goods or merchandise to which the section applies, which condition is fulfilled by the assessee. In computing total turnover income of the assessee, the deduction of the profits derived by the assessee from export of such goods or merchandise is allowed in accordance with and subject to the provisions of this section. Sub-section (2)(a) of Section 80HHC of the Act provides that the section shall apply 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. This condition is also fulfilled by the assessee. Sub-section (3) states that for the purposes of sub-section (1), how the said profit has to be computed. Clause (c) of sub-section (3) which is relevant for deciding this case provides 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 in respect of such goods or merchandise manufactured or processed by the assessee, be the amount which bears to the adjusted under the heading "profits of the business", in 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. The explanation to the said sub-section defines what is "adjusted export turnover", "adjusted profits of the business" and also "adjusted total turnover". In order to arrive at the "adjusted profits of the business", we have to go by the definition of "profits of the business" contained in Explanation (baa) to Section 3(A) which reads as under:

"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 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.

This provision was inserted by Finance (No. 2) Act, 1991 with effect, from

1-4-1992. In order to appreciate this provision, the legislative intent behind this provision is to be looked into. By reason of such amendment, parliament did intend that income derived by way of brokerage/commission interest, rent, charges, or any other receipt of a similar nature by the assessee should not be reckoned for the purpose of computing profit or loss earned by a person engaged in the business of export. The purport and reason for enacting Section 80HHC of the Act indisputably was to provide incentive to export houses. The formula that existed prior to 1991 often used to provide a distorted figure of export profits when receipts like interest, commission etc., which did not have an element of turnover were included in the profit and loss account. Therefore it was clarified that "profits of the business" for section 80HHC would not include receipts by way of brokerage, commission, interest or any other receipt of a similar nature. The expression "income arising out of business of export" brings within its sweep not only the export of any goods or merchandise manufactured or processed by the assessee but also of trading goods. Parliament, therefore, intended to provide incentive when a positive profit is earned by an exporter.

7. This provision came up for consideration before the Supreme Court in K. Ravindranathan Nair's case (supra). After referring to the entire provision, it was held as under:

21. At the outset, we may state that in the present case, we are dealing with the law as it stood during asst. yr. 1993-94. At that time s. 80HHC(3) of the IT Act constituted a code by itself. Subsequent amendments have imposed restrictions/qualifications by which the said provision has ceased to be a code by itself. In the above formula there existed four variables, namely, business profits, export turnover, total turnover and 90 percent of the sums referred to in cl. (baa) to the said Explanation. In the computation of deduction under s. 80HHC all four variables had to be taken into account. All four variables were required to be given weightage. The substitution of s. 80HHC(3) secures profits derived from the exports of eligible goods. Therefore, if all the four variables are kept in mind, it becomes clear that every receipt is not income and every income would not necessarily include element of export turnover. This aspect needs to be kept in mind while interpreting cl. (baa) to the said Explanation. The said clause stated that 90 percent of incentive profits or receipts by way of brokerage, commission, interest, rent, charges or any other receipt of like nature included in business profits, had to be deducted from business profits computed in terms of ss. 28 to 44D of the IT Act. In other words, receipts constituting independent income having no nexus with exports were required to be reduced from business profits under cl. (baa). A bare reading of cl.(baa)(1) indicates that receipts by way of brokerage, commission, interest, rent, charges etc. formed part of gross total income being business profits. But, for the purposes of working out the formula and in order to avoid distortion of arriving export profits cl.(baa) stood inserted to say that although incentive profits and "independent incomes" constituted part of gross total income, they had to be excluded from gross total income because such receipts had no nexus with the export turnover. Therefore, in the

above formula, we have to read all the four variables. On reading all the variables it becomes clear that every receipt may not constitute sale proceeds from exports. That, every receipt is not income under the IT Act and every income may not be attributable to exports. This was the reason for this Court to hold that indirect taxes like excise duty which are recovered by the taxpayers for and on behalf of the Government, shall not be included in the total turnover in the above formula (Sec: CIT v. Lakshmi Machine Works (supra))

The question which arose for consideration in the aforesaid judgment was "whether the department was right in including processing charges in the total turnover while arriving at export profits u/s 80HHC(3) of the Act as it stood at the relevant time". After holding that it is to be included in the total turnover, it was observed as, it constituted an independent income in terms of clause (baa), it had to be deducted from gross total income to arrive at business profits to which fraction had to be applied as it constituted an independent income similar to rent, commission, etc., which form part of the gross total income. It was held that all that the incentive profits and "independent incomes" constituted part of gross total income, they had to be excluded from export turnover because such receipts had no nexus with the export turnover. Every receipt may not constitute sale proceeds from exports. That every receipt is not income under the IT Act and every income may not be attributable to exports. In the end, it was stated that nature of every receipt needs to be ascertained in order to find out whether the said receipt forms part of/or that it has an attribute of an export turnover.

8. The Madras High Court had an occasion to consider the aforesaid provisions in somewhat similar situation in K.R.M. Marine Exports Ltd. Vs. Assistant Commissioner of Income Tax, wherein it was held as under:

The frozen and processed goods were exported and the charges relating to the same are directly linked to the export receipts. However, the Tribunal also without assigning any reason held that freezing and processing charges stand as all distinct and separate payment purely for service rendered and not to be treated as forming part of the sale proceeds of the goods sold to TEL Export House. We are not able to approve the way in which this point was dealt with by the authorities. The export profits are required to be computed in the ratio of export turnover to total turnover as contemplated in the formula i.e., $\text{export profit} = \frac{\text{business profit} \times \text{export turnover}}{\text{total turnover}}$. If we consider the business of the assessee, which is manufacturing and processing and export of marine products, the income derived for freezing and processing of marine products - but for that operation the export cannot be made - is an income earned by using the entire undertaking of the company i.e., machinery and power and other manufacturing and administrative set up. The sum so received could be regarded as business profit. The said factual findings have not been disputed by any of the authorities. In these circumstances, we are of the view that the freezing and processing charges would definitely form part of one of the components of business profits, as the activity of freezing and processing would

have a direct and immediate nexus to the activity of export.

9. The Bombay High Court also had an occasion to consider the aforesaid question in the light of the judgment of the Apex Court, in the case of The Commissioner of Income Tax Vs. Pfizer Ltd., In determining whether a receipt which forms part of the profits of business is liable to undergo a reduction of ninety percent as stipulated in clause (1) of Explanation (baa), it is necessary for the Court to consider whether the receipt is "of a similar nature included in such profits." The rationale for excluding ninety percent of the receipts by way of brokerage, commission, interest, rent or charges is that these are independent incomes and their inclusion in the profits of business would result in a distortion. In determining whether any other receipt is liable to undergo a reduction of ninety percent the basic prescription which must be borne in mind is whether the receipt is of a similar nature and is included in the profits of business. To be susceptible of a reduction the receipt must be of a nature similar to brokerage, commission, interest, rent or charges. Dealing with the facts of the said case, it was held as under:

A contract of insurance is a contract of indemnity. The insurance claim in essence indemnifies the assessee for the loss of the stock in trade. The indemnification that is made to the assessee must stand on the same footing as the income that would have been realized by the assessee on the sale of the stock in trade. In these circumstances, we are clearly of the view that the insurance claim on account of the stock in trade does not constitute an independent income or a receipt of a nature similar to brokerage, commission, interest, rent or charges. Hence, such a receipt would not be subject to a deduction of ninety percent under clause (1) of Explanation (baa).

Now it is necessary to note that Explanation (baa) in terms does not refer to export turnover. Sub-section (1) of Section 80HHC of the Act contemplates a deduction to the extent of profits derived from the assessee from the export of goods or merchandise to which the section applies. The basis issue therefore is to determine the extent of profits derived by the assessee from the export of such goods or merchandise. The formula in sub section (3) of Section 80HHC has been provided by Parliament, for the purposes of sub-section (1) to compute the profits derived from the export of goods. Clause (a) of sub-section (3) specifies that where the export is of goods or merchandise manufactured or processed by the assessee the profits derived from the export shall be the amount which bears to the profits of 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. In other words, in determining the profits derived from the export of goods or merchandise the proportion of the export turnover to the total turnover of the business is applied to the profits of the business. The profits of the business in turn are defined in Explanation (baa) to Section 80HHC. Hence, the element of export turnover is a facet which has been taken care of by the Legislature in the application of the formula which is referred to in sub-section

(3) of Section 80HHC. In determining the profits of the business for the purposes of Explanation (baa), the incomes which are susceptible to a reduction of ninety percent are those which are specifically prescribed by the legislature. These are inter alia the incomes referred to in clauses (iiia), (iiib) and (iiic) of Section 28 and receipts by way of brokerage, commission, interest, rent, charges or receipts of a similar nature included in such profits. Therefore, before a receipt is liable to be excluded to the extent of ninety per cent, it must be a receipt of a nature similar to brokerage, commission, interest, rent or charges.

10. The Apex Court in the case of Commr. of Income Tax-IV, Tamil Nadu Vs. B. Suresh, has observed under:

9. The basic requirement of section 80HHC is earning in foreign exchange and retention of profits for export business. Profits are embedded in the "income" earned. Earning of income depends on sale of goods and services. Today the difference between the two is getting blurred with globalisation and cross-border transaction. Today with technological advancement one has to change our thinking regarding concepts like goods, merchandise and articles.

11. From the aforesaid discussion, it is clear that in computing the profits of the business for the purpose of Explanation (baa), the incomes which are deductible are those which are expressly prescribed in the aforesaid provision and which are similar in nature. If the income is derived out of the activity which would have direct and immediate nexus to the activity of export, then the said income is not deductible from the said profits of the business under the aforesaid provisions. Profits are embedded in the income earned by such export business. The difference between the concepts like goods, merchandise, service, articles, etc., is getting blurred with globalization and technological advancement. If any income is derived from export and by way of foreign exchange, such income is not deductible and the benefit of that income has to be given to the assessee. The expression "Any other receipt of a similar nature", has to be understood in the context of the words preceding the said expression namely "brokerage", "commission", "interest", "rent", or charges, such receipts have no nexus with the income earned by way of foreign exchange. Every receipt is not income and every income would not necessarily include element of export turnover. This aspect needs to be kept in mind while interpreting Explanation (baa) to two said sections. The basic requirement of section 80HHC is earning in foreign exchange and retention of profits for export business. Though the object of enacting 80HHC of the Act, is to provide incentive to export business and thus, earning foreign exchange, the said benefit should go to only exporters and should not be misused in getting the benefit when there is no element of export involved in the income. Keeping in mind the legislative intent, it is clear that such incomes which have no direct nexus with the export turnover are liable to be deducted in arriving at the profits of the business. It was only when the assessee has an independent income which has no nexus with the income derived from export, which is in the nature of brokerage, commission, interest, rent or charges, and

by inclusion of that income to the profits of the business, result in distortion, then, such income should be excluded.

12. In the instant case, it is not in dispute that the assessee is in the business of export of goods and merchandise. The assessee is earning foreign exchange out of that export. The disputed income is earned by the assessee for his fees towards developmental work from M/s. Robert Bosch. The developmental work is intimately connected with the business of manufacturing and sale of goods by the assessee. There is immediate nexus between the activity of export and the developmental work. Admittedly, for the services rendered by way of these developmental work, the assessee has been given the benefit of deductions u/s 80-O of the Act. The receipt of consideration from a foreign enterprise is not in dispute. From the very same business that the assessee is carrying on, he is having an income under two heads and therefore, it is not a case of any independent income unrelated to or unconnected with the business carried on by the assessee is sought to be included in the profits of the business. In these circumstances, the Tribunal was justified in holding that the said consideration received for developmental work is not liable to be deducted under clause (baa) in computing the profits of the business. The said order is legal and valid. It does not suffer from any legal infirmity. Therefore, we answer the aforesaid substantial question of law in favour of the assessee and against the revenue. Accordingly, the appeal is dismissed. No costs.