
(1990) 05 DEL CK 0019

In the Delhi High Court

Case No : Income-tax Reference No"s. 110 to 112 of 1987

Continental Construction Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 24-05-1990

Acts Referred:

Citation : (1990) 69 CompCas 268 : (1990) 85 CTR 116 : (1990) 185 ITR 178 : (1991) 54 TAXMAN 412

Hon'ble Judges : C.L. Choudhary, J;B.N. Kirpal, J

Bench : Division Bench

Advocate : N.A. Palkhiwala, for the Appellant; B.B. Ahuja, for the Respondent

Judgement

Kirpal, J.—The Income Tax Appellate Tribunal, Delhi, has referred for the opinion of this court, in respect of the assessment year 1983-84, at the instance of the assessed, the following four questions of law :

"(1) Whether, on the facts and in the circumstances of the case, the Tribunal is right in holding that the income arising from the activities pursuant to the seven agreements with foreign Governments/enterprises, etc., are governed by the provisions of section 80HHB of the Income Tax Act, 1961, and not of section 80O of that Act ?

(2) Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that notwithstanding the approvals granted by the Board to the seven agreements for the purpose of section 80O, for the purpose of assessment for the assessment year 1983-84, the income arising from these contracts have to be brought u/s 80HHB of the Income Tax Act, 1961 ?

(3) Whether, on the facts of the case, the Tribunal is right in holding that the income from the entire activities under the seven agreements cannot be bifurcated and is wholly covered u/s 80HHB of the Income Tax Act, 1961 ?

(4) Whether, on the facts and in the circumstances of the case, the Tribunal is

right in holding that the assessed-company is not an "industrial company" as defined in the Finance Act, 1982 ?"

2. At the instance of the respondent the Tribunal has referred the following question of law :

"Whether, on the facts and in the circumstances of the case, the Tribunal was correct in holding that, having regard to the provisions of sections 40(c) and 40A(5)(b) of the Income Tax Act, the remuneration paid to the directors in respect of their employment outside India has to be excluded from the limit of Rs. 72,000 laid down in the first proviso to section 40A(5)(A) as well as section 40(c) of the Income Tax Act, 1961 ?"

3. The facts, as stated by the Tribunal, are that the assessed is a civil construction company which had executed a large number of projects outside India. The overseas projects include dam and irrigation and hydel projects in Libya, fibre board factory at Abu-Sukhair in Iraq and the biggest project executed by the assessed was the Karkh Water Supply Project, Baghdad, having a total value of 534 million dollars.

4. The claim of the assessed was that the profits earned in respect of the seven foreign contracts were exempt u/s 80O of the Income Tax Act. The profits in respect of which exemption was claimed were as follows :

Profits Amount in (Rs.) West Bank P/L a/c. as per unit 1,79,19,557.95 Amara -do- 1,29,874.29 Nassiriya -do- 40,83,758.31 Karkh -do- 77,84,29,446.40 Diwaniyah -do- 6,36,85,435.84 Sulaimaniyah -do- 77,51,151.61 Wadi Ghan -do- 1,86,19,973.71 ----- 89,16,19,198.11 -----

5. The aforesaid seven contracts were entered into on various dates between August 8, 1977, and January 10, 1981. The contracts were either with a foreign Government or an enterprise of a foreign country. Under the provisions of section 80O of the Income Tax Act, 1961 (hereinafter referred to as "the said Act"), these contracts had been submitted to the Board for its approval. Whereas, in respect of five contracts the approval u/s 80O had been accorded in the earlier years, the contracts in respect of Karkh and Diwaniyah projects were approved on October 28, 1983. These contracts were approved from the year of inception and the later years, in respect of four projects. However, in respect of the Amara project, the approval had been granted for the assessment years 1979-80 to 1982-83, as asked for by the assessed. In respect of Karkh and Diwaniyah projects, the Board's approval was for the assessment year 1982-83 only. The letters of approval of the Board issued on October 28, 1983, had drawn the attention of the assessed to the fact that from April 1, 1983, that section would be operative. Later on, by a subsequent order dated July 31, 1985, the Board changed the language of the approval and made it applicable the assessment year 1982-83 and onwards.

6. Assessment for the year 1983-84 was made by the Inspecting Assistant Commissioner who came to the conclusion that the income from the aforesaid

contracts was covered by the provisions of section 80HHB of the Income Tax Act which had been introduced with effect from April 1, 1983. According to him, the contracts were civil building contracts and the total consideration was for the execution of the work. He also observed that the basic planning and specification had been made out by the various Governments or enterprises and the assessed only executed the work and he further held that there was no provision for giving any technical know how or rendering of technical services. Having regard to the provisions of section 80HHB, the income from these projects, according to the Inspecting Assistant Commissioner, could not be considered under any other provision. In fact, he went to the extent of observing that the provisions of section 80O were never applicable to the agreements entered into by the assessed with foreign Governments or enterprises. According to the Inspecting Assistant Commissioner, the personnel sent by the assessed abroad were mostly non-technical persons and only a few of them were so qualified. The claim of the assessed u/s 80O was, Therefore, rejected and it was held that the assessed could not get the benefit of section 80HHB also as the conditions laid down in that section were not fulfilled .

7. The appeal filed by the assessed against the disallowance of the foresaid deduction came up for consideration before the Commissioner of Income Tax (Appeals). Accepting the contention of the Department, the Commissioner of Income Tax (Appeals) held that because of section 80HHB, and the provision of sub-section (5) thereof, in particular, the consideration of relief u/s 80O was ruled out in such cases. The Commissioner of Income Tax (Appeals) further held that any approval granted by the Board under the particular provision was subject to amendment in law and other conditions laid down in the Income Tax Act from time to time. The Commissioner of Income Tax (Appeals) referred to the amendment made in section 80O from April 1, 1975, as a result of which the benefit under that section was withdrawn for non-corporate assesseds. He pointed out that even in such cases where the approvals had been granted earlier in the case of non-corporate assesseds, they could not get the benefit in later years. Looking at the nature of the contracts, the Commissioner of Income Tax (Appeals) came to the conclusion that these contracts were in the nature of turnkey projects as the consideration was one whole without the possibility of any bifurcation. He, Therefore, came to the conclusion that the income from these contracts were squarely covered by section 80HHB and, Therefore, notwithstanding the approval granted by the Board u/s 80O, the income from these projects could not be brought under that section as they were covered u/s 80HHB. In respect of the assessed's claim for deduction u/s 80HHB, the Commissioner of Income Tax (Appeals) set aside the matter and remanded the same to the Assessing Officer.

8. Being aggrieved, the assessed filed an appeal against the aforesaid order of the Commissioner of Income Tax (Appeals) before the Tribunal. The contention of the assessed before the Tribunal was that it was entitled to deduction u/s 80O of the said Act.

9. The Tribunal considered the facts and the rival arguments. It was observed by the Tribunal that the treatment of such contracts by the Board and the approval of such contracts u/s 80O for the earlier years must have been in accordance with the policy of the Government. The approval was for the contract and the mention of the assessment year with respect to which this approval was applicable was redundant. The Tribunal observed that though as many as seven contracts were involved in the computation of income in this year, the major submissions were made in respect of the Karkh and Diwaniyah works, firstly, because they involve the highest amounts of payments and profits and, secondly, because there had been a modification of the original approval and a later clarification given by the Board. Analysing the legal position, the Tribunal took note of the provisions of section 80HHB and it was found that it related to execution of foreign projects which included contracts for construction and did not exclude any such work on the basis of its being sophisticated or highly complicated. The Tribunal referred to sub-section was absolute in its terms and it makes section 80HHB the first provision to be considered for allowance of deduction under this sub-Chapter and if it is found that the whole consideration or the income payable to the assessed for the execution of the foreign projects is covered under this section, the assessed cannot get deduction under any other section under this Chapter. In a case where it is possible to hold that only a part of the consideration is payable to the assessed for the execution of a foreign project, then the other part of the consideration would not be hit by this provision of law and that can be considered for deduction under other sections. After noting the various requirements of section 80O, the Tribunal considered the nature of the contract under the Karkh Water Supply Scheme which had been placed before the Tribunal as, according to the assessed, other works were also of similar nature. Giving the details of the work and the nature of the contract, as well as the provisions for payment of consideration, the Tribunal came to the conclusion that it was a contract for commissioning of a turnkey project for the Karkh Water Supply Scheme. It was not possible in this contract to separate one part from the other or to bifurcate a part of the consideration for any particular service. Thus, the contract was found to be one indivisible and integrated contract of the whole work. As the consideration was for execution of a foreign project and the contract was one and not capable of bifurcation, the Tribunal held that no part of the income was arising as fees or royalty from rendering of technical services under the contract. The Tribunal referred to the non-obstante clause of section 80HHB(5) and observed that the very fact that the Legislature thought it fit to introduce this sub-section while introducing this section in the Income Tax Act shows that the Legislature was aware of the possibility of the consideration and the income covered u/s 80HHB to be also partly covered under other provisions of that sub-Chapter. However, as there was a prohibition for deduction under any other section, the claim of the assessed could not be considered under any other section. It was further held by the Tribunal that notwithstanding the approval granted by the Board u/s 80O, the matter had to be considered in this assessment year under the law as it stood at the relevant

time. It was observed that, in an appropriate case, it may be found that there is a contract for rendering of technical services apart from the execution of the project and separate consideration is contemplated for some technical services. In such a case, the provisions of section 80O would still be applicable to that part. The Tribunal further rejected the plea of the assessed regarding promissory estoppel. Referring to the confusion created by the qualified approval followed by modification of that approval and the clarification given, the Tribunal held that the matter had to be decided in accordance with the provisions of law and not the confusion which might have been created due to any action taken by any authority. The Tribunal, Therefore, held that the income and consideration received by the assessed in the execution of all the seven contracts in general, and the Karkh work in particular, fell under the provisions of section 80HGB as the contracts were for the execution of the projects. It was further held that in view of the provisions of section 80HGB(5), the claim of the assessed u/s 80O could not be considered in spite of the approval granted by the Board.

10. One of the other questions which was considered by the Assessing Officer, the Commissioner of Income Tax (Appeals) and the Income Tax Tribunal was whether the assessed could be regarded as an industrial company for the purpose of determining the rate of tax applicable, while the Commissioner of Income Tax (Appeals) allowed the claim of the assessed and held it to be an industrial company, the Tribunal, following a decision of this court in the case of Commissioner of Income Tax, Delhi-I Vs. Minocha Brothers P. Ltd., , held that the assessed could not be considered as an industrial company. In this connection, it was further observed that the amendment made by the Finance Act, 1983, in the assessment year 1983-84 but it was applicable for the later years.

11. From the above points decided by the Tribunal, the aforesaid four questions of law have been raised by the assessed.

12. One more issue involved in these references relates to the addition made by the Inspecting Assistant Commissioner in respect of the remuneration paid to the directors which is above Rs. 72,000 per annum. Before the Commissioner of Income Tax (Appeals), the assessed did not dispute the disallowance made in respect of the directors posted in India. Besides remuneration of Rs. 60,000 per annum, they were also paid certain commission which had been fixed under their terms of appointment. Some of the directors were looking after the company's work outside India and, according to the terms of their appointment, a part of the remuneration as well as the commission paid to them was in U.S. dollars. Such commission had been paid to two directors and the total of such payments came to Rs. 6,49,56,646. These directors were looking after the company's work in Iraq and Libya. The assessed claimed that, u/s 40A(5)(b)(i), the disallowance contemplated does not apply to any employee in respect of any period of his employment outside India. The Commissioner of Income Tax (Appeals) held that the directors working abroad were also employees of the company and section 40A has to be applied notwithstanding anything to the contrary contained in any

other provision of the Income Tax Act. He further referred to the reference to section 40(C) in section 40A(5) itself and held that, in deciding the issue, the provisions of section 40A(5) were applicable and the remuneration paid for work done outside India had not to be considered for disallowance. An appeal was filed by the Department before the Tribunal against the aforesaid decision but without success. At the instance of the Department, one question of law, set out hereinabove, has been referred to this court.

13. Pursuant to the orders of the Tribunal, applications u/s 256(1) were filed by the assessed as well as the Department. The Tribunal reframed the questions and stated the case and referred the aforesaid questions of law to this court.

14. In deciding questions Nos. 1 to 3, which are inter-related and inter-connected, the main questions which arise for consideration are as to what is the full scope and effect of the provisions of sections 80HHB and 80O of the Act and under which provision do all or any of the agreements entered into between the assessed and the foreign enterprises fall.

15. In order to examine the rival contentions, it is first necessary to refer to the provisions of section 80HHB and 80O.

16. The topic, namely, deduction in respect of royalties, etc., from certain foreign enterprises, was first dealt with by section 85C which was inserted in the Income Tax Act with effect from April 1, 1966. By the Finance (No. 2) Act, 1967, section 80O was inserted in place of 85C with effect from April 1, 1968. Amendments were made to the said section from time to time and during the previous year relevant to the assessment year 1983-84, with which we are concerned, the said section read as follows :

"80-O. Where the gross total income of an assessed, being an Indian company, includes any income by way of royalty, commission, fees or any similar payment received by the assessed from the Government of a foreign State or a foreign enterprise in consideration for the use outside India of any patent, invention, model, design, secret formula or process, or similar property right, or information concerning industrial, commercial or scientific knowledge, experience or skill made available or provided or agreed to be made available or provided to such Government or enterprise by the assessed, or in consideration of technical services rendered or agreed to be rendered outside India to such Government or enterprise by the assessed, under an agreement approved by the Board in this behalf, and such income is received in convertible foreign exchange in India, or having been received in convertible foreign exchange outside India, or having been converted into convertible foreign exchange outside India, is brought into India, by or on behalf of the assessed in accordance with any law for the time being in force for regulating payments and dealings in foreign exchange, there shall be allowed, in accordance with and subject to the provisions of this section, a deduction of the whole of the income so received in, or brought into, India in computing the total income of the assessed :

Provided the application for the approval of the agreement referred to in this sub-section is made to the Board before the first day of October of the assessment year in relation to which the approval is first sought :

Provided further that approval of the Board shall not be necessary in the case of any such agreement which has been approved for the purposes of the deduction under this section by the Central Government before the first day of April, 1972, and every application for such approval of any such agreement pending with the Central Government immediately before that day shall stand transferred to the Board for disposal."

17. By the Finance Act, 1982, section 80HHB was incorporated in the Income Tax Act, 1961. According to the Memorandum explaining the provisions in the Finance Bill, it was stated that, with a view to encourage contractors to undertake construction and engineering contracts outside India, it was proposed to provide a tax relief on the profits derived by them from foreign contracts. In the Bill as presented to Parliament the section contained only four sub-sections. Thereafter, while passing the Finance Act, 1982, sub-section (5) was also inserted and with effect from April 1, 1983, section 80HHB was enacted. The said section 80HHB as enacted is as follows :

"80HHB. Deduction in respect of profits and gains from projects outside India. -

(1) Where the gross total income of an assessed being an Indian company or person (other than a company) who is resident in India includes any profits and gains derived from the business of -

(a) the execution of a foreign project undertaken by the assessed in pursuance of a contract entered into by him, or

(b) the execution of any work undertaken by him and forming part of a foreign project undertaken by any other person in pursuance of a contract entered into by such other person, with the Government of a foreign State or any statutory or other public authority or agency in a foreign State, or a foreign enterprise, there shall, in accordance with and subject to the provision of this section, be allowed, in computing, the total income of the assessed, a deduction from such profits and gains of an amount equal to twenty-five per cent. thereof :

Provided that the consideration for the execution of such project or, as the case may be, of such work is payable in convertible foreign exchange.

(2) 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, (46 of 1973), and any rules made there under;

(b) "foreign project" means a project for -

(i) the construction of any building, road, dam, bridge or other structure outside

India;

(ii) the assembly or installation of any machinery or plant outside India;

(iii) the execution of such other work (of whatever nature) as may be prescribed.

(3) The deduction under this section shall be allowed only if the following conditions are fulfilled ,namely :-

(i) the assessed maintains separate accounts in respect of the profits and gains derived from the business of the execution of the foreign project, or, as the case may be, of the work forming part of the foreign project undertaken by him and, where the assessed is a person other than an Indian company or a co-operative society, such accounts have been audited by an accountant as defined in the Explanation below sub-section (2) of section 288 and the assessed furnishes, along with his return of income, the report of such audit in the prescribed form duly signed and verified by such accountant;

(ii) an amount equal to twenty-five per cent. of the profits and gains referred to in sub-section (1) is debited to the profit and loss accountancy of the previous year in respect of which the deduction under this section is to be allowed and credited to a reserve account (to be called the "Foreign Projects Reserve Account") to be utilised by the assessed during a period of five years next following for the purposes of his business other than for distribution by way of dividends or profits;

(iii) an amount equal to twenty-five per cent. of the profits and gains referred to in sub-section (1) is brought by the assessed in convertible foreign exchange into India, in accordance with the provision of the Foreign Exchange Regulation Act, 1973 (46 of 1973), and any rules made there under, within a period of six months from the end of the previous year referred to in clause (ii) or, where the Commissioner is satisfied (for reasons to be recorded in writing) that the assessed is, for reasons beyond his control unable to do so within the said period of six months, within such further period as the Commissioner may allow in this behalf :

Provided that where the amount credited by the assessed to the Foreign Projects Reserve Account in pursuance of clause (ii) or the amount brought into India by the assessed in pursuance of clause (iii) or each of the said amount is less than twenty-five per cent. of the profits and gains referred to in sub-section (1), the deduction under that sub-section shall be limited to the amount so credited in pursuance of clause (ii) or the amount so brought into India in pursuance of clause (iii), whichever is less.

(4) If at any time before the expiry of five years from the end of the previous year in which the deduction under sub-section (1) is allowed, the assessed utilises the amount credited to the Foreign Projects Reserve Account for distribution by way of dividends of profits or for any other purpose which is not a purpose of the business of the assessed, the deduction originally allowed under

sub-section (1) shall be deemed to have been wrongly allowed, and the Income Tax Officer may, notwithstanding anything contained in this Act, re-compute the total income of the assessed for the relevant previous year and make the necessary amendment; and the provisions of section 154 shall, so far as may be, apply thereto, the period of four years specified in sub-section (7) of that section being reckoned from the end of the previous year in which the money was so utilised.

(5) Notwithstanding anything contained in any other provision of this Chapter under the heading "Deductions in respect of certain incomes," no part of the consideration payable to the assessed for the execution of a foreign project referred to clause (a) of sub-section (1) or of any work referred to in clause (b) of that sub-section shall qualify for deduction for any assessment year under any such other provision."

18. On behalf of the assessed, it was contended that section 80HHB and section 80O do not overlap. It was submitted that the case of the petitioner was covered by section 80O and in respect of the assessment years prior to 1983-84, its income from foreign projects was being allowed as a direction under the said section. It was further submitted that the intention of the Legislature in inserting section 80HHB was to provide additional benefit to those assesseds who were not covered by section 80O. According to learned It was further submitted that, in the instant case, the agreements of the assessed had been approved by the Board under the provisions of section 80O and, Therefore, it was not open to the Income Tax authorities to challenge or to go behind the same. The Income Tax authorities were bound to accept the correctness of the said decision of the Board and, it was submitted, they could not hold or even investigate whether the agreements fall under the provisions of section 80HHB or not. In other words, once the Board granted approval u/s 80O, the Assessing Officer was precluded from holding that the income of the assessed from those projects did not fall u/s 80O but in fact was covered by the provisions of section 80HHB.

19. On behalf of the respondents, Shri Ahuja submitted that section 80O could not apply to a contract like the present which was a single indivisible contract. In other words, income from turnkey projects was not entitled to deduction u/s 80O of the Act. According to Shri Ahuja, the assessed could claim a deduction only u/s 80HHB, provided other conditions in the said provision were complied with. In the alternative, it was submitted by Shri Ahuja that even if it be held that a turnkey project could be covered in section 80O, nevertheless the income which would be entitled to deduction u/s 80O must be a fee, royalty or commission or similar and payment and, in the present case, on a proper construction of the contracts, it was not possible to hold that the assessed had received any income of that nature. In short, the submission of Shri Ahuja was that what the assessed had received were business profits from the execution of its work outside India and that those profits could not be regarded as income which is referred to in section 80O, namely, fee, royalty or commission. In support of his contention

that a turnkey contract cannot be bifurcated, strong reliance has been placed on the decision of the Supreme Court in the case of *State of Madras v. Gannon Dunkerley and Co. (Madras) Ltd.* [1958] 9 STC 353 and of this court in the case of *SIMON CARVES INDIA LTD. Vs. CENTRAL BOARD OF DIRECT TAXES AND ANOTHER.*, .

20. Before considering the various decisions which have been referred to by learned counsel, it will be more appropriate to analyze the two sections, namely, section 80O and section 80HHB, in order to understand their full import and effect.

21. The Supreme Court, in *Petron Engineering Construction Pvt. Ltd. and Another Vs. Central Board of Direct Taxes and Others*, , considered the provisions of section 80O and observed that the following conditions must be fulfilled so as to attract the provisions of that section (at p. 527) :

- "1. The assessed must be an Indian company.
2. The income by way of royalty, commission, fees, etc., must be received by the assessed from the Government of a foreign state or a foreign enterprise.
3. The consideration shall be for the use outside India of any patent, invention, model, design, etc., made available or provided to such Government or enterprise by the assessed or technical services rendered or agreed to be rendered outside India to such Government or enterprise by the assessed.
4. The agreement must be approved by the Board.
5. The income received by the assessed shall be in convertible foreign exchange.
6. The deduction shall be in respect of the whole of such income received in or brought into India."

22. All the aforesaid conditions have to be satisfied by the assessed in order to claim deduction u/s 80O. Analysing the provision further, it will be noticed that it is not any type of income which is entitled to the benefit under the said provision. The income, to which the said provision applies, must be of the nature of royalty, commission, fee or similar payment. Broadly speaking, this type of income is usually derived not from the supply or sale of tangible goods. A royalty is usually received by giving a right to another person to use a property belonging to the owner. For example, royalty has been stated to be compensation paid under a license granted by the owner of a patent or a copyright to another person who wishes to use the same, the right which the owner has is an intangible commodity though the same is in respect of a material object, namely, a patent or a drawing. Similarly, commission is usually paid for services rendered by one person to another. A fee would also be receipt of money for services rendered, for example, by a professional engineer or an architect. The services which are to be rendered, in such a case, are in discharge of their professional functions and duties. According to the said provision, any other payment which is

received should also be of a similar nature in order that a claim u/s 80 can be made. Broadly speaking, the income which is contemplated u/s 800 which is entitled to the benefits under the said provision has to be either for professional services rendered or a receipt for permission to use an intellectual property of assessed. This evident from the fact that the section itself states that the income which is received is to be in consideration, for use outside India, of any patent, invention, model, design, secret formula, process or information concerning industrial, commercial, scientific knowledge, experience or skill. All this would fall in the category of, what is more commonly known as, "know-how". In other words, section 800 was enacted with a view to give benefit to Indian companies for the supply of know-how including information concerning industrial, commercial or scientific knowledge, experience or skill. Section 800 is also applicable in the case of receipt of consideration for technical services rendered outside India but then again, this income which is received must necessarily be by way of royalty, fee or commission or a similar payment.

23. Another important ingredient of section 800 is that the information, design, etc., has to be made available, for use outside India, to a foreign Government or enterprise or that the services should be rendered outside India to such Government or enterprise.

24. The contention of Shri Palkhivala is that, in the execution of a turnkey project like the present, there is, necessarily, supply of information and services to the foreign Government or enterprise. It is contended that the execution of the project envisaged that drawings would be made, technical data collected, engineering skill provided and the project being executed. The preparation of the drawings and supply of technical services could have been by one contract and another contract could have been entered into for doing the civil engineering work. The fee received under the first contract would be entitled to the benefit u/s 800. The submission was that merely because, instead of two separate contracts, the assessed had entered into a single composite contract would not mean that the income which would fall u/s 800, if separate contracts were entered into, would not be entitled to any deduction merely because a single composite agreement has been entered into.

25. Shri Ahuja, on the other hand, contended that, in a turnkey project like the present, services are not rendered to a foreign Government, nor is information provided to the foreign Government and in fact information is provided and services are rendered for execution of a turnkey project by a contractor to the contractor himself. The submission of learned counsel is that one of the basic ingredients of section 800 is that the information which is supplied or services which are rendered have to be used outside India not by the assessed himself but by the foreign Government or enterprise or its nominee.

26. Eliminating unnecessary words and focusing attention on this aspect of the section, section 800 would read as follows :

"Where the gross total income of an assessed... by way of royalty... received by assesseds from the Government of a foreign State... in consideration for the use outside India of any patent, invention,.. or information concerning... scientific knowledge, experience or skill made available... to such Government... or in consideration of technical services rendered, outside India to such Government..."

27. The section contemplates the use of any patent, invention, etc., outside India which patent, design, etc., is provided by the Indian company to such foreign Government. The section also specifies that technical services are to be of such a nature which are rendered outside India to such foreign Government. It is clear, Therefore, that the information which is supplied or technical services which are rendered is meant for the benefit of, or for the use of, the foreign Government or enterprise. Regarding the supply of a patent, invention, model, design, etc., for a royalty, commission or fee, there are four different types of situations which may arise and we have to consider whether section 80O would be attracted in those situations or not.

28. The first situation may be where there is a contract by an Indian company with the foreign Government for the supply of a patent, invention or design for use outside India for a royalty, commission or fee to be paid by the foreign Government to the Indian company. Thereafter, it is the foreign Government which itself uses the information supplied by the Indian company and executes the project. In such a case, there can be no doubt that the said provisions of section 80O are satisfied.

29. The second situation which may arise is where technical information is supplied by the Indian company to the foreign Government which then employs another independent organisation to execute the work. In such a case, the technical information which is supplied by the Indian company has not been made use of by the foreign Government itself, inasmuch as the project is not executed by the foreign Government, but those drawings and technical information are used by another organisation, though for the benefit of the foreign Government. Such a situation will arise where the foreign Government engages the Indian company as a technical consultant and another organisation or company as civil engineering contractors who would be required to carry out the construction as per the drawings and technical data supplied by the Indian company. In such a situation also, there can be little doubt that the ingredients of section 80O would be satisfied because even if the technical data is not used by the foreign Government itself, it has, nevertheless, been used by a nominee or agent of the foreign Government, namely, the civil engineering contractor. Use by the civil engineering contractor of the technical data supplied by the Indian company will, in law, be regarded as use of the information by the foreign Government itself.

30. A third situation which may arise is where the Indian company supplies a patent. Invention, model, design, etc., for a royalty, fee or commission. Thereafter, in response to a subsequent tender enquiry, another contract or

agreement is entered into by the same Indian company for the execution of the civil work for which the consideration to be paid is different. Can it be said that the royalty, fee, commission, etc., received by the Indian company for the supply of the patent, invention, model, design, etc., is not eligible for the benefits of section 80O merely because the civil engineering works are to be executed by the company itself, though under a different contract ? It appears to us that, in such a case, the Indian company would have, in a sense, a dual entity. It will be regarded as a supplier of technical information to the foreign Government for which it will receive a royalty, fee, commission, etc., and this information, etc., which is supplied is then used by that very Indian company as an agent of the foreign Government for executing the work. If an Indian company named "A" supplies technical information and the same is used, in response to an independent contract with that foreign Government, by another Indian company called "B" who carries out the civil engineering works, then if company "A" is entitled to claim deduction u/s 80O, it would not stand to reason a logic that the benefit in respect of supply of that technical data would be lost if instead of company "B" it is company "A" itself which executes the civil engineering work. For getting additional work, the Indian company "A" should not be denied the benefits of section 80O which it would undoubtedly be entitled to receive if that civil engineering work was executed by another Indian company named "B". The two agreements, namely, for the supply of technical data for which a specified amount or rate of fee, commission or royalty is fixed and the other for the execution of the civil engineering works have to be regarded as distinct and different from each other. Section 80O does not specify that the use outside India of the patent, invention or design has to be by the foreign Government or enterprise itself. The section only requires the technical data, like a patent, invention, or design, being "made available or provided to such Government or enterprise". The right to claim deduction u/s 80O arises the moment fee is received and the same is brought into India in consideration of the technical data being made available to the foreign Government for use outside India even if the foreign Government chooses not to use the technical data which is supplied. Even if the foreign Government abandons its idea of executing the work, nevertheless, the provisions of section 80O would be attracted on the receipt by the Indian Company of any royalty, commission or fee in respect of the technical data so supplied. To put it differently, the actual use or non-use of the technical data supplied by the Indian company to the foreign Government for royalty, commission, fee, etc., is of no consequence in deciding whether the income so received is deductible u/s 80O or not as long as what is supplied is meant for use outside India. Taking this to its logical extent, it would imply that it is equally immaterial, for this section to apply, to consider as to who has used this technical information which is supplied to the foreign Government. If technical information is, under an agreement, supplied to a foreign Government for a royalty, commission or fee, then whether the project is subsequently executed by the foreign Government or enterprise itself or by another company or organisation is of no relevance. The execution of the project is distinct from the supply of

technology from India. Section 80O is concerned with the income arising from the supply of technology and it is immaterial who subsequently makes use of that technology.

31. If the technical information provided to a foreign Government or enterprise can be used by the recipient or by another company, as an agent or nominee of that foreign Government or enterprise, and the Indian company is entitled to the benefit of section 80O in respect of the income arising there from, will it be logical that the provisions of section 80O would be inapplicable if, by a separate agreement, the technology supplied is used by the Indian company for executing the project ? In our opinion, the answer to this must be in the negative, provided the conditions contemplated by section 80O are satisfied. If there are two distinct and separate contracts between the foreign Government or enterprise and the Indian company, one for the supply of technology for a royalty, commission or fee and another for the execution of work or project pursuant thereto, then the first contract can come within the ambit of section 80O provided the other requirements of the said section are fulfilled. This would be for the reason that there would be a transfer of knowledge or technology by the Indian company to the foreign Government or enterprise for a royalty, commission or fee and the income which is generated at that point of time in respect of the technology so transferred would be entitled to deduction u/s 80O, we do not find any indication in section 80O which would deprive the Indian company, supplying technology under an agreement, being deprived of the benefits of section 80O merely because, subsequently or separately, by another agreement, that Indian company is also entrusted with the responsibility of executing the work.

32. The fourth situation which may arise is where a single composite contract is entered into between the Indian company and the foreign Government or enterprise for the execution of a project outside India. If such a contract contemplates, in execution thereof, the use of any invention, design, secret formula, etc., as well as the execution of the work, then will the provisions of section 80O be attracted to the whole or any part of the contract ? In other words, if there is a turnkey project which is undertaken by an Indian company which envisages work being done which is in the nature of and as contemplated by section 80O as well as other work being performed which is outside the scope of section 80O, can the benefit of section 80O be made available to the Indian company ? The contention of Shri Palkhivala was that the composite agreement should be split into different portions and the slice which falls u/s 80O should be entitled to deduction under the said provision. Shri Ahuja, however, submits that it is not permissible to bifurcate a single indivisible contract into different portions.

33. At this stage, it would be relevant to refer to the guidelines issued by the Central Board of Direct Taxes, these guidelines have been issued for approval of agreements, which agreements have to be approved u/s 80O of the Act. The Board first issued, in this connection, Circular No. 187 dated 23-12-1975 (See

Commissioner of Income Tax Vs. P.N. Nagaraj and Another, of the same was as follows :

"3. (ix) In the case of a composite agreement specifying a consolidated amount as consideration for purposes which include matters outside the scope of section 800 (e.g., use of trade marks, supply of equipment, etc.,) the amount of the consideration relating to the provision of technical know-how or technical services, etc., qualifying for purposes of section 800 will have to be determined by the Income Tax Officer separately at the time of assessment after due appreciation of the relevant facts. Where, however, in the opinion of the Board, it will not be possible to properly ascertain and determine the amount of the consideration relatable to the provisions of the know-how or the technical services, etc., qualifying for section 800, the Board may not approve such an agreement for the purposes of section 800 of the Act."

34. The said circular also provided that the deduction u/s 800 would be subject to fulfilling of the other conditions laid down in the section and that the actual amount eligible for deduction will be determined by the Income Tax Officer at the time of assessment. Subsequently, another Circular No. 253 (see [1980] 126 ITR 21 was issued by the Board in clarification of clause (ix) of paragraph 3 of the aforesaid Circular No. 187. In the new circular, it was, inter alia, stated as follows :

"It was also stated in para 3(ix) of the circular dated 23-12-1975 that in the case of a composite agreement which specified a consolidated amount as consideration for purposes which included matters outside the scope of section 800, the Board may not approve such an agreement for the purposes of section 800 of the Act if it was not possible to properly ascertain and determine the amount of the consideration relatable to the provision of the know-how or technical services, etc., qualifying for section 800. Thus, the benefit of section 800 could be denied to the entire amount of royalty, commission, fees, etc., receivable under such an agreement. It has since been decided that in such cases approval would be granted by the Board subject to a suitable disallowance for the non-qualifying services after taking into consideration the totality of the agreement, so that the balance of the royalty/fees, etc., which is for the services covered by section 800, can be exempted."

35. According to the guidelines laid down by the Board and which are contained in the aforesaid circulars, it is clear that a composite agreement is not excluded from the benefit of section 800 of the Act. Whereas the earlier Circular No. 187 had, inter alia, provided that where it was not possible to properly ascertain or determine the amount of consideration relatable to the provisions of know-how or technical services, the Board would not, in such a case, approve the agreement u/s 800 but, in the latter Circular No. 253, it has been provided that even in such cases, approval would be granted "subject to a suitable disallowance for the non-qualifying services after taking into consideration the totality of agreement, so that the balance of the royalty/fees, etc., which is for

the services covered by section 80O can be exempted". According to these circulars, a composite agreement can be split and that slice which falls u/s 80O can be given the benefit of the said provision.

36. Both the Circulars Nos. 187 and 253 contemplated income from a part of a composite agreement being eligible for deduction u/s 80O of the Act. The difference between the two circulars is that whereas in the first circular it was provided that if it was not possible to properly ascertain and determine the amount of the consideration, then approval was not to be granted. This meant that there was to be, for the determination of the consideration relatable to the provision for know-how, no approximation or guess work. The consideration had to be properly ascertainable and determinable. The later circular No. 253, however, provided that approval would be granted even if it was not possible to properly ascertain or determine the amount of the consideration. By providing that there would now be suitable disallowance for non-qualifying services by taking into consideration the totality of the agreement, the Board indicated that a certain amount of estimation was permissible. In Income Tax law, it is well recognised, for example, when the books of account are rejected, that profits or income which may be subject to tax may have to be estimated. A similar principle seems to have been incorporated in the later Circular No. 253. It is, however, pertinent to note that in the later Circular No. 253 it is clearly provided that what would be entitled for disallowance is the "balance of the royalty, fees, etc.,". In other words, the amount which is allowable is to be in the nature of royalty and fee and not anything else. This is in consonance with the provisions of section 80O. To put it differently, even the approximate figure out of a consolidated amount of consideration mentioned in a composite agreement which is to be allowed as deduction u/s 80O has to be in the nature of royalty, fee or commission and not anything else.

37. The important question, however, is, what is "a composite agreement" as understood by the Board in its Circular No. 187 and Circular No. 253 ? Paragraph 3(ix) refers to that type of "a composite agreement specifying a consolidated amount as consideration for purposes which include matters outside the scope of section 80O (e.g., use of trade marks, supply of equipment, etc.,)..." This part of paragraph 3(ix) indicates the type of a composite agreement to which the two circulars were referring. The said circulars were not referring to a composite agreement providing for the execution of a turnkey project but the composite agreements referred to was one where some of the provisions of the agreement, which fall u/s 80O, could be separated from the other provisions, for example, the use of trade marks, supply of equipment, etc., This is in consonance with the form of the application for approval which, inter alia, requires an applicant to give an answer to the following query :

"6. Does the agreement provide for supply of technical know-how or rendering of any services other than those covered by section 80O (e.g., use of trade marks or supply of goods) if so, please specify them and also the amount of

consideration receivable/received in respect of them."

38. The composite agreement which is, Therefore, referred to in the two circulars is such which provides for making available or giving materials, etc., by the Indian company in addition to providing for information, etc., contemplated by section 80O. The two circulars do not in any way refer to the execution of a turnkey project as being covered by the provisions of section 80O.

39 It is at this stage that it becomes relevant to consider, in greater detail, the decision of this court in the case of SIMON CARVES INDIA LTD. Vs. CENTRAL BOARD OF DIRECT TAXES AND ANOTHER., . In that case, a composite turnkey contract had been entered into by the assessed whereby it was required to design, construct and installation a plant for the manufacture of sulphuric acid as per specifications, and deliver the drawings for a total consideration of Rs. 74,19,670. This price included a know-how and design fee of Rs. 4,65,000. It was held that section 80MM, inter alia, applied only to that technical know-how which was likely to assist in the manufacture or processing of goods or materials or in the installation or erection of machinery or plant for such manufacture or processing. As the installation and erection of machinery and plant had been done by the assessed itself, under the turnkey contract, this court came to the conclusion that there was no supply of know-how, and the know-how remained with the assessed because the contract was executed by the assessed itself. Section 80O also requires that a royalty, commission, fee, etc., be paid in consideration of the patent, invention, model, design, etc., being "made available or provided or agreed to be made available or provided..." to the foreign Government or enterprise. The difference in the language of section 80MM and section 80O is not of any material significance. Whereas section 80MM contemplated technical know-how assisting in the installation of the machinery, etc., section 80O clearly provides for information being made available or provided to the foreign Government or enterprise. Just as the installation or erection of the machinery did not amount to the transfer of know-how, as held in SIMON CARVES INDIA LTD. Vs. CENTRAL BOARD OF DIRECT TAXES AND ANOTHER., , similarly, the execution of a turnkey project cannot amount to making available or providing to the foreign Government or enterprise information regarding patent, invention, design, etc., Just as in SIMON CARVES INDIA LTD. Vs. CENTRAL BOARD OF DIRECT TAXES AND ANOTHER., , it was held by this court that the technical know-how was used by the company itself and there was no rendering of technical know-how to the foreign party, similarly, in section 80O also, execution of a turnkey project does not have the effect of any technical information being made available or provided to a foreign Government or enterprise and, in fact and in law, the technical information which helped in the execution of the project is provided by the contractor to himself. In a turnkey project, it is not possible to determine as to how much money, if any, is received by the Indian company by way of royalty, fee or commission. When a lump sum payment is to be made for a turnkey project to be executed by an Indian company and the execution of the project involves preparations of designs,

models, etc., then, at the time of the execution of the agreement, it cannot be known as to what is the amount which is likely to be received by way of royalty, fee or commission. If an agreement provides for separate consideration by way of royalty, fee or commission in respect of technical information, drawings, etc., and those drawings or technical information are made available to the foreign Government or enterprise, then it may be possible to come to the conclusion that in a composite agreement, the amount of royalty, fee or commission which is receivable can be ascertained or has been specified. The royalty, fee or commission which may be payable may be a fixed amount or may be determinable at a stipulated rate. Where, however, a lump sum amount is to be paid for the execution of a contract, it is possible to find out what is the amount of consideration receivable in respect of supply of technical know-how or rendering of other services which are covered by section 80O. The type of composite agreement which was referred to in the aforesaid circulars of the Board was where there was supply of commodities and things as well as technical know-how, some of which was covered by section 80O and for which the amount of royalty, commission or fee was ascertainable. The circulars did not contemplate a composite agreement of a type which involved the execution of a project like constructing a dam or water works where it is impossible to determine from the agreement itself the consideration relating to matters falling within the scope of section 80O. The said circulars contemplated a situation where a consolidated amount was payable and it would be easy to determine the value of matters outside the scope of section 80O and exclude the same from the total consideration payable and the resultant figure would be regarded as relating to matters falling within the scope of section 80O.

40. In the present case, while in answer to the query which had been raised by the Board it had been stated by the petitioner that the income which was received was in consideration of information concerning industrial, commercial or scientific knowledge, experience or skill made available but, during the course of arguments before the Tribunal, the emphasis was that the consideration which was received by the petitioner was in respect of technical services to be rendered to the Government of Iraq. In the present case, the project was being executed by the Indian company itself. Technical services which are rendered in the execution of a project may involve engaging architects, engineers and other skilled workmen. Section 80O requires that the technical services should be rendered by the Indian company to the foreign Government or enterprise. If the civil and other works were being executed by the Government of Iraq or by any other nominee or agent of the said Government and the assessed had sent its engineers and other skilled personnel, then it could be said that technical services were being rendered by the Indian company to such Government or enterprise. But where, in the execution of a turnkey project by the Indian company, technical persons help the assessed itself in the execution of the said project, it cannot be said that any technical services are rendered to the Government of Iraq.

41. Technical services are rendered to the person who is actually executing the work though the work, when finished, may be for the benefit of a foreign Government. The concept of rendering of technical services can be explained in another way. If, for example, a person "A" places an order on person "B" to design, manufacture and supply a television set and the person "B" then employs "C" to design and manufacture the same, for which "C" receives his remuneration from "B" and television set is then supplied by "B" to "A", can it be said that "C" has rendered any technical services to "A". The answer, in our opinion, must be in the negative. In the aforesaid example, "C" will be regarded as having rendered technical services to "B" but it cannot be said that "C" rendered any technical services to "A". The privity of contract was between "A" and "B" where "B" was required to supply a manufactured item. All those persons who helped in the manufacture of the item assist "B" and not "A". Similarly, in the execution of a turnkey project, it is the Indian company, as a contractor, which receives technical services from various engineers and other skilled personnel but it is not possible to conclude that those persons who helped the Indian company in completing the project in fact and in law rendered technical services to the foreign Government. Just as technical information, like in SIMON CARVES INDIA LTD. Vs. CENTRAL BOARD OF DIRECT TAXES AND ANOTHER., is supplied to oneself and not to the foreign Government or enterprise, similarly, technical services are also not rendered to the foreign Government but are rendered to oneself. It is not, Therefore, possible to accept the contention of the assessed that, in the execution of the turnkey project, the assessed rendered any technical services to the foreign Government or enterprise.

42. From the aforesaid discussion, it will follow that, in the turnkey project, neither is it possible to determine the amount of royalty, commission or fee which may be payable and nor is in fact any technical know-how supplied or made available by the Indian company to the foreign Government or enterprise. Technical information, in the execution of a turnkey project, always remains with the Indian company and is made available to and used by itself.

43. It was then submitted by learned counsel for the assessed that the Department cannot go behind the approval which had been granted u/s 800 by the Board. The submission was that, u/s 800, an agreement has to be approved by the Board before deduction u/s 800 can be claimed. According to learned counsel, the Board grants the approval only after it is satisfied that the agreement in question is of the type that would fall u/s 800. The decision of the Board is not mechanical. The Board is not a registering authority which is required to merely take note of every agreement which is entered into by the Indian company with a foreign party but the Board is, u/s 800, obliged to apply its mind and examine the agreement and, thereafter, either to grant or refuse approval. Once approval is granted, then the subordinate authorities, specially the Income Tax Officer, have no jurisdiction to challenge the correctness of the said decision, the according of the approval must necessarily imply that the agreement is one which provides for income being received from royalty,

commission or fee in consideration of technical know-how or technical services being made available to a foreign Government or enterprise. Once approval is granted, it is not open to the assessing authority to re-examine the terms of the agreement and hold that the conditions laid down in section 80O are not satisfied. Shri Palkhivala contended that the discipline and integrity of the tax administration required that the decision of the highest authority, namely, the Board, should not be questioned by a subordinate authority. Reliance, in this connection, was placed on the decision of the Bombay High Court in the case of Commissioner of Income Tax Vs. Parrys (Eastern) (P.) Ltd., . In that case, the Central Government had accorded approval u/s 85C of the Act to an agreement which had been entered into between the Indian company and Stank import, Moscow. Section 85C, which required approval of the Central Government, was similar to section 80-O which required the approval of the Board. In Commissioner of Income Tax Vs. Parrys (Eastern) (P.) Ltd., , the Additional Commissioner did not grant deduction u/s 80-O which was enacted on the deletion of section 85C, inter alia, for the reason that Stank import was not a foreign company and that the letter was not an agreement between the parties and that no commercial or technical services were rendered there under. The Tribunal decided in favor of the assessed and the Bombay High Court came to the conclusion that "the Central Government having found in respect of the assessed's application u/s 85C that the three essential and common requirements were met, the Additional Commissioner ought to have so proceeded and not held to the contrary." Reliance was also placed on Gestetner Duplicators Pvt. Ltd. Vs. Commissioner of Income Tax, West Bengal, .

44. There, a provident fund had been recognised by the Commissioner of Income Tax but the Income Tax Officer sought to disallow the deduction claimed by interpreting the expression "salary" in rule 2 (h) of Part A of the Fourth Schedule to the Act so as to exclude the commission that was paid by the assessed to its salesmen. It was contended by the assessed that Part A of the Fourth Schedule required that the various conditions set out therein had to be satisfied before recognition could be granted by the Commissioner of Income Tax. Once recognition was accorded, then it meant that all the conditions in the Fourth Schedule were satisfied and what was being paid by way of commission was in fact salary and that the Income Tax Officer could not come to a contrary conclusion. The Supreme Court made some observations with regard to the true impact of the recognition granted by the Commissioner of Income Tax. It was noted that recognition had been granted after the true nature of the commission which was paid had been considered and the grant of recognition implied that the provident fund of the assessed satisfied all the conditions laid down in Part A of the Fourth Schedule to the Act. The Supreme Court then observed that (at p. 15) "in that situation we do not think that it was open to the taxing authorities to question the recognition in any of the relevant years on the ground that the assessed's provident fund did not satisfy any particular condition mentioned in rule 4. It would be conducive to judicial discipline and the maintaining certainty

and uniformity in administering the law that the taxing authorities should proceed on the basis that the recognition granted and available for any particular assessment year implies that the provident fund satisfies all the conditions under rule 4 of Part A of the Fourth Schedule to the Act and not sit in judgment over it."

45. In our opinion, the aforesaid observations in *Gestetner Duplicators Pvt. Ltd. Vs. Commissioner of Income Tax, West Bengal*, would be equally applicable where approval is accorded u/s 80O of the Act. As already observed, the Board cannot be regarded as merely a registering authority. When agreements are sent to the Board for approval, a detailed questionnaire is filled in by the assesseds. Discussion takes place between the representatives of the Board and the assessed and, thereafter, the Board either grants or rejects approval.

46. If the contention of Shri Ahuja is correct, that is open to the Assessing Officer to decide on merits whether the conditions u/s 80O are satisfied, notwithstanding the grant of approval by the Board, the effect of this would be that where, for example, the Board refuses to grant approval but this court directs the Board to grant approval and approval is granted, the Assessing Officer can thereafter have the right or authority to decide whether the agreement fulfills the conditions of section 80O. In our opinion, giving the Assessing Officer the authority or power to go into the questions which have been examined in detail by the Board, or by the court and which has resulted in the according of the approval would be clearly contrary to judicial discipline. If the approval, as envisaged u/s 80O or section 80MM, is granted, then, in our opinion, the Assessing Officer cannot take a decision which is contrary to or which has the effect of nullifying the approval so granted.

47. In the present case, however, we find that the approval which was granted was not an unqualified one. In the case of grant of approval in respect of the Karkh Water Supply Scheme, one of the questions which was put to the assessed was whether the agreement provided "for supply of technical know-how or rendering of any services other than those covered by section 80O (e.g. use of trade marks or supply of goods). If so, please specify them and also the amount of consideration receivable/received in respect of them". In reply to this, the assessed stated that the agreement provides for supply/use of goods like machinery, plant, equipment, vehicles, etc., and that the cost of supply of these items will be determined at the close of each year as the work progresses. It was further provided that, after taking out the net cost of machinery and equipment from the total value of the contract, the remaining amount will be the value of technical know-how and services to be rendered under the contract which would be entitled to exemption u/s 80-O. It will be seen that it was not the case of the assessed that, at least in this application, the work which was awarded was a turnkey project. The Board, vide its letter dated October 28, 1983, while granting approval for the assessment year 1982-83 and onwards (the words "and onwards" having been added by virtue of the letter dated July 31, 1985), nevertheless stated that "the grant of deduction from the total income will be

subject to your fulfilling the other conditions laid down in the Act in this behalf. The amount eligible for deduction will be determined by the Income Tax Officer at the time of assessment". If this letter, requiring the determination of the amount to be deducted by the Income Tax Officer, is read Along with Circular No. 253 of the Board which, inter alia, provides that, in the case of a composite agreement, there shall be suitable disallowance for non-qualified services, it would mean that it is left to the Income Tax Officer to decide what amount, if any, is entitled to the deduction u/s 80-O. Though the effect of the approval granted by the Board is that the agreement is generally of the nature as contemplated by section 80-O, nevertheless, by stating that the amount which is eligible for deduction will be determined by the Income Tax Officer at the time of assessment means that the decision of the Board was only tentative or prima facie.

48. The Income Tax Officer can determine the amount which is eligible for deduction only by determining which part of the income falls u/s 80O. If the Board had not left it to the Income Tax Officer to determine the amount which is eligible for deduction, then it could possibly have been contended that the Income Tax Officer had no jurisdiction to examine the agreement in order to see which part of the receipt fell within section 80O and which did not. But this is not the case here. Even though the Board has accorded approval u/s 80O, it did not state that the entire income or any specific portion thereof would be entitled to deduction u/s 80O. For reasons best known to them, the Board had left it to the Income Tax Officer to determine as to what portion of the amount to be received was eligible for deduction. According to the Tribunal, the Commissioner of Income Tax sought clarification from the Board with regard to the approval which it had granted to the assessed. In response thereto, the Board stated that, in spite of approval u/s 80O, if the income does not satisfy the requirement of that section, the assessed would not be entitled to such deduction. In this letter, it was also stated that the mention of the assessment years in the approval orders was redundant. If, Therefore, the Income Tax Officer came to the conclusion that deduction was not available because of the incorporation of section 80HHB or because of the income not falling under the provisions of section 80O, then such a conclusion cannot be regarded as being contrary to the opinion of the Board for the simple reason that the Board itself, while according approval, has empowered the Income Tax Officer to determine as to what amount is allowable as deduction u/s 80O. The Income Tax Officer can come to the conclusion that there is no income which falls under the provisions of section 80O or that, even though the contract or agreement may be providing for rendition of technical services or information, nevertheless it is not possible to conclude that any income by way of royalty, fee or commission has been paid to or received by the assessed. When, in the letter of approval, it is provided that the assessed will have to fulfill other conditions laid down in the Act in order to be entitled to the grant of deduction, the Income Tax Officer had to satisfy himself as to whether the conditions laid down in section 80O were also fulfilled .If the Income Tax Officer

finds that information or technical services have not been rendered to the foreign Government or enterprise or that the amount which is received is not in the nature of royalty, fee or commission then, by virtue of the letter of approval itself, the Income Tax Officer would be justified in coming to the conclusion that these conditions laid down in section 80O have not been complied with or fulfilled by the assessed. We are, Therefore, unable to agree with learned counsel for the assessed that, in the instant case, the decision of the tax authorities is in any way contrary to the approval granted by the Board. The Board's approval was a qualified one and it fully authorised and empowered the Income Tax Officer to determine whether all the conditions laid down in the Act had been fulfilled and, secondly, what is the amount, if any, which could be deducted u/s 80O.

49. There have been numerous cases before this court where such approvals have been rejected which has resulted in a number of writ petitions being filed questioning the correctness of the decision of the Board in refusing to grant the approval. In all such cases, it has always been contended by the Board that the agreements were of the type which did not entitle the applicants to the grant of approval u/s 80O and 80MM. The court, time and again, examined the correctness of the decisions of the Board and then either dismissed the writ petitions or directed the Board to consider the matter afresh with regard to the grant of approval. Some of such cases are : J.K. (Bombay) Ltd. Vs. Central Board of Direct Taxes and Another, , OBEROI HOTELS (INDIA) P. LTD. Vs. CENTRAL BOARD OF DIRECT TAXES AND OTHERS., , Lurgi India Co. P. Ltd. Vs. Central Board of Direct Taxes and Another, , E.P.W. Da Costa and Another Vs. Union of India (UOI), , Ghai Lamba Catering Consultants P. Ltd. Vs. Central Board of Direct Taxes and Another, and SIMON CARVES INDIA LTD. Vs. CENTRAL BOARD OF DIRECT TAXES AND ANOTHER., .

50. In J.K. (Bombay) Ltd. Vs. Central Board of Direct Taxes and Another, , a question arose whether the services of managing agents rendered by an Indian company to a foreign Government were "technical services" within the meaning of section 80O of the Act. The Board had declined to grant approval on the ground that the said services could not be regarded as technical services. The said decision was challenged by filing a petition under article 226 of the Constitution. This court, inter alia, held, while dismissing the writ petition, that the object of section 80O is best known to the Ministry of Finance which conceived the idea of giving this incentive to the Indian companies and the Central Board of Direct Taxes administered this provision. Considerable importance had, Therefore, to be given to the understanding of this provision by the Board. It was further observed that it is only if the understanding of section 80O by the Board shows an error of law apparent on the face of the record that the court would have to interfere with the rejection of an application. If, however, the decision of the Board is in keeping with the object of section 80O and is a reasonable construction of the words, then the court would not be called upon to interfere under article 226.

51. SIMON CARVES INDIA LTD. Vs. CENTRAL BOARD OF DIRECT TAXES AND ANOTHER., has already been referred to and need not be considered afresh except to note that while the court held that in executing a turnkey project, there could be no question of transferring know-how relating to installation or erection of machinery or plant, it was observed that the said section 80MM also referred to the provision of technical know-how which was likely to assist in the manufacture or processing of goods or material. As this question had not been considered by the Board, the Board was directed to reconsider the application whether the technical drawings assisted in the manufacture or processing of goods or material or in the working or use of a design plant.

52. In Lurgi India Co. P. Ltd. Vs. Central Board of Direct Taxes and Another, , the question arose as to what was the meaning of the expression "technical know-how" occurring in section 80MM. The Central Board had declined to grant the approval but this court held that a techno-economic feasibility study relating to a project for setting up a sponge iron plant with an electric steel-making and continuous billet casting plant was technical know-how and that the Board should reconsider the application accordingly.

53. Ghai Lamba Catering Consultants P. Ltd. Vs. Central Board of Direct Taxes and Another, related to an agreement which had been entered into between the assessed and a foreign company to promote and establish a company in England. The Indian company was to get a certain percentage of the profits from the English company so promoted which company was to enter into the restaurant business. Application u/s 800 was refused by the Board because, in its opinion, the said agreement resulted in a joint venture and the services to be rendered were not those as contemplated by section 800. Upholding this conclusion, this court held that the agreement was not of the type which would fall under the provisions of section 800 and the money which it was entitled to receive which, inter alia, represented 25% of the initial net profits could not be termed "royalty, commission, fees or any similar payment".

54. In Gannon Dunkerley and Co. Ltd. and another Vs. Central Board of Direct Taxes and others, the assessed had entered into an agreement with Engineering Projects (India) Limited who, in turn, had an agreement with the Government of Kuwait for executing a defense project. In the agreement between the assessed and E.P.I., the employer was to be the Ministry of defense of the Government of Kuwait and the assessed worked as a sub-contractor of EPI. The Central Board of Direct Taxes declined to grant the approval on the ground that the agreement was with an Indian company. This refusal of the Board to grant approval was challenged and a single judge of the Bombay High Court came to the conclusion that the agreement made it clear that the employer was the Government of Kuwait and, Therefore, the assessed was entitled to the benefit u/s 800 of the Act. In this connection, it was observed that a superficial and narrow interpretation would defeat the benevolent purpose behind section 800 and the substance of the matter is likely to get shrouded under a technicality which

cannot be permitted to supersede the decided dominant intention of this provision. The court, in that case, was primarily concerned with the question whether there was an agreement of the assessed with the Indian company or with the foreign Government. That is not the question which arises before us and, Therefore, that case is clearly distinguishable. We would, however, like to observe that the court did not consider and analyze section 80O in detail as no arguments appear to have been addressed on the question as to whether, in a turnkey project, there can be rendering of technical assistance to the foreign Government or enterprise in consideration of royalty, fee or commission.

55. In the case of OBEROI HOTELS (INDIA) P. LTD. Vs. CENTRAL BOARD OF DIRECT TAXES AND OTHERS., , an agreement had been entered into with the foreign company by the assessed whereby it had to manage a hotel of the foreign company at Kathmandu. The Board did not approve the agreement, inter alia, on the ground that the services which were being rendered were in the nature of managerial services and did not amount to rendering of technical services. Furthermore, it could not be said that any information concerning industrial, commercial or scientific knowledge or skill was being supplied to the foreign party as, under the agreement, the assessed itself was functioning in the foreign country. The said refusal was challenged and this court had held that the earlier decision in J.K. (Bombay) Ltd. Vs. Central Board of Direct Taxes and Another, did not apply because Oberoi Hotels were rendering technical services to the foreign company and it was not managing the foreign company. The services which were rendered by the assessed were not akin to the services that a managing agency renders and section 80O was applicable to that case. Nevertheless, with regard to the applicability of the first part of section 80O, the court observed as follows (at page 272 of 135 ITR) :

"The learned counsel for the petitioner also argued that in any case the petitioner-company was entitled to the approval of the agreement under the first part of section 80O inasmuch as it was making available the information concerning industrial, commercial or scientific knowledge, experience or skill to the foreign company. On a careful consideration of this argument, we are unable to agree that the petitioner-company is giving any such information to a foreign company inasmuch as there is no provision in the agreement referred to above."

56. It is clear from the aforesaid observations that because skilled work was being undertaken by Oberoi Hotels itself, the benefit was accorded to it under the latter portion of section 80O and this court was clearly of the opinion that it had not imparted or given any information concerning industrial, commercial or scientific knowledge, experience or skill to the foreign company. In that case, technical services were rendered to the foreign company but, in the case of execution of a turnkey project, technical services are rendered to the person who is executing the project, namely, the company itself.

57. Deduction u/s 80HHB of the Income Tax Act can be claimed only in the following circumstances :-

(1) The assessed is an Indian company or a person (other than a company), who is resident in India.

(2) His gross total income includes any profit and gains.

(3) The profits and gains must be derived from the business of execution of a foreign project undertaken by the assessed pursuant to a contract entered into by him or from execution of any work undertaken by him which forms part of the foreign project undertaken by any other person e.g., sub-contractor, pursuant to a contract entered into by such other person.

(4) The contract or undertaking of the project should be with a foreign Government or State or public authority or agency in a foreign State or with a foreign enterprise.

(5) The consideration should be payable in convertible foreign exchange.

(6) Conditions specified in sub-section (3) of section 80HHB are fulfilled relating to maintaining separate account, crediting to reserve account an amount equal to 25% of the profits and gains and 25% of the profits and gains is brought by the assessed in convertible foreign exchange, within the stipulated period.

58. The essential difference between section 80HHB and section 80O is that whereas the income which falls u/s 80O has to be in the nature of royalty, commission or fee, u/s 80HHB, the reference is to "profits" and "gains" derived from the business. If the execution of the foreign project also entails designing and planning, etc., of the project which is to be executed but the consideration, in respect thereto, which arises is in the nature of profits or gains derived from a business, then the amounts of profits or gains relatable to designing and planning, assuming this can be ascertained, would be covered by section 80HHB and not section 80O. In a business venture, there may be profit or there may be loss. Section 80HHB relates to business profits or gains. On the other hand, receipt of royalty, commission or fee is not regarded, in common parlance, as receipt from business. These payments are received not in consideration of carrying on of a business, but the fee and commission which are received are in consideration of services rendered, while the royalty is usually regarded as a compensation paid under a license granted by the owner of an intellectual property, whether it be a patent or a copyright.

59. The term "royalty, commission and fee" also came up for consideration before the Calcutta High Court in Commissioner of Income Tax Vs. Stanton and Stavely (Overseas) Ltd., . After reviewing numerous decisions and also referring to the Encyclopedia Britannica, it was observed by the court that "Royalty may be said to be a compensation paid under a license granted by the owner of a patent to another person who wishes to make use of the invention, the subject of the patent. A royalty may be a single payment covering the whole term, but the more usual practice is to make periodic payments for the actual use of the patent by the licensee. It was common to charge royalties on the basis of a percentage

of price which the licensee sells the articles or on the basis of the number of articles made under the patent. After referring to Ramanatha Aiyar's Law Lexicon, the court noted with approval that in the said Law Lexicon "the fees have been described as charge or compensation for particular acts or services; reward or compensation for services rendered or to be rendered; a payment in money for official or professional services, whether the amount would be optional or fixed by custom; compensation paid to professional men, as an attorney or physician."

60. With regard to the word "commission", reference was made to the decision in the case of Harihar Cotton Pressing Factory Vs. Commissioner of Income Tax, Bombay North, and it was observed as under (headnote) :

"There the court was concerned with the expression "commission". The expression "commission" had no technical meaning but both in legal and commercial acceptation of the term it has a definite signification and is understood as an allowance for service or labour discharging certain duties such as, for instance, of an agent, factor, broker or any other person who manages the affairs or undertakes to do some work or renders some service to another. Mostly, it was a percentage on price or value or upon the amount of money involved in any transaction of sale or service or the quantum of work involved in a transaction. It could be for a variety of services and was of the nature of recompense or reward for such services."

61. From the aforesaid decision in Commissioner of Income Tax Vs. Stanton and Stavely (Overseas) Ltd., , it may be reasonable to conclude that the first part of the section 80O deals with receipt of royalty, commission or fee in consideration of an intellectual property right being allowed to be used by the foreign Government or enterprise and the latter part of section 80O refers to similar type of money being received in consideration of professional services being rendered, namely, the rendering of technical assistance.

62. Furthermore, it appears to us that, in the agreement, there has to be a definite basis for the charge of a fee, commission or royalty. Either a sum which is so charged is specified or a rate at which the royalty, fee or commission can be ascertained has to be mentioned in the agreement itself. Royalty, fee or commission should be determinable and it has to be an ascertainable sum or a rate. For example, in the agreement, a particular sum may be specified as being charges payable by way of royalty, fee or commission or a certain percentage of the gross or net turnover may be mentioned as being the royalty, fee or commission which may become payable. In both the cases, some royalty ,fee or commission will have to be received by the contractor. On the other hand, if no such basis of ascertaining royalty, fee or commission is specified in the agreement and it is represented, like in the present case, that the total consideration minus the expenses will represent royalty, fee or commission, then sum which is received cannot be regarded as royalty, fee or commission. The said sum which is received is in fact profit which is earned from a business

transaction which has been carried out. If the expenses are more than the contracted payment which is to be received, in a turnkey project, the result would be that there is a loss which is suffered. If the basis of calculating the consideration in respect of technical information which is supplied is to be the one which is adopted by the assessed in the present case, then it would mean that no money will be received in respect of technical information which is supplied. Section 80O decided ones not postulate such a situation. Royalty, fee or commission are receipts which are different in nature from profit which is referred to section 80HHB. Profit is derived from carrying on of the business and it is not necessary that, in the execution of every project, there shall be profit. On the other hand, section 80O contemplates that there must always be receipt of money in consideration of information which is imparted to the foreign Government or enterprise. The contention of the assessed, as already stated, is that the payment contemplated by section 80O will be ascertained after deducting expenses from the total consideration received from the foreign Government. This surplus of income over expenditure cannot, in our opinion, be termed as royalty, fee or commission. This surplus can only be regarded as profit earned by the assessed from the execution of a project.

63. It was then contended by counsel for the assessed that section 80HHB does not contemplate receipt of consideration in respect of drawings or technical information which may be supplied by the assessed to the foreign Government or party. The submission was that the word "project" means only a project for construction or the undertaking of civil engineering work and that planning, designing, etc., was not included in the meaning of the expression "execution of a foreign project". Laying emphasis on the word "execution", it was submitted that there must be a plan in existence which is to be executed.

64. We are unable to agree with the aforesaid contention. We see no justification for giving a restricted meaning to the expressions "execution of a foreign project" or "execution of any work". Sub-section (2)(b) of section 80HHB defines a "foreign project" as, inter alia, meaning a project for the construction of any building, road, dam, bridge or other structure outside India, assembly or installation of any machinery outside India. As per the Oxford English Dictionary, the word "project", inter alia, means "to plan, contrive, devise or design (something to be done, or some action or proceeding to be carried out); and "to plan, devise or design to do something".

65. It is clear from the aforesaid meaning ascribed to the word "project" that it includes planning or designing or doing something. Therefore, in the execution of a turnkey project, where designing and planning of the work is contemplated, the provisions of section 80HHB would be clearly attracted. Where drawing or designing or imparting technical information forms an integral part of the execution of a project and there is no separate or ascertainable royalty, commission or fee payable in respect of the designing, planning and technical information which may be provided, then the income from the total consideration

which is received would be entitled to the benefit of section 80HHB and not section 80O.

66. The Tribunal relied upon sub-section (5) of section 80HHB while coming to the conclusion that the provisions of section 80HHB applied to the assessed's case. Section 80HHB(5), inter alia, provides that no part of the consideration or income which is referred to in sub-section (1) shall qualify for deduction for any assessment year under any such other provision. In other words, if any income which arises from the execution of a foreign project falls u/s 80HHB and any other section, then the claim of the assessed will be restricted only u/s 80HHB and that income would not be entitled to get benefit under any other provision. In our opinion, the question of invoking section 80HHB(5) in the present case does not arise because the assessed's income falls only u/s 80HHB and no part of it is covered by section 80O. The income which is contemplated by section 80O is different and distinct from the income which falls u/s 80HHB. Whereas the income u/s 80O has to be in the nature of royalty, commission or fee, the income referred to in section 80HHB is in the nature of a business profit. Whereas the income referred to section 80O is either in consideration of the technical services rendered or as a consideration for the use outside India of a patent, model, design, etc., the income contemplated u/s 80HHB is one which arises out of the assessed executing a project. There is no giving to a foreign state or enterprise of any patent, invention, model, design, etc., or parting with any information concerning industrial, commercial, scientific knowledge, etc., in the execution of a foreign project by the assessed himself. The technical information or skill necessary for the execution of a foreign project is not imparted by the assessed to the foreign Government or enterprise, but it is used by the assessed himself. Therefore, the execution of the work by the assessed, in the present case, falls u/s 80HHB and not u/s 80O.

67. While referring to the Karkh Water Supply contract, it was submitted by learned counsel for the assessed that the agreement was a composite agreement and was not a turnkey project. We find that this contention was neither raised nor dealt with by the Tribunal. Nevertheless, there is no merit in this submission. In the instructions to the tenderers, in clause 1.1, it has been stated as follows :

"The Baghdad Water Supply invites experienced engineering consortia to submit tenders for the design, manufacture, delivery, construction or installation complete under a single contract of the works required for Stage I (910 MLD capacity) of the Karkh Water Supply Scheme".

68. The aforesaid clause of the invitation to tender clearly shows that the tenders are being invited for a single contract for the complete works. The contractor had to carry out all the functions, namely, designing, manufacturing, delivery, etc., and in consideration thereof a lump sum payment was to be made to the contractor. In our opinion, this clearly shows that the project which had to be executed by the assessed was a turnkey project.

69. For the aforesaid reasons, questions Nos. 1 to 3 are answered against the assessed and in favor of the Revenue.

70. As regards question No. 4, a Division Bench of this court in the case of Commissioner of Income Tax, Delhi-I Vs. Minocha Brothers P. Ltd., has held that a company engaged in the business of construction of buildings, etc., is not to be regarded as an industrial company. Following this decision, the answer to the fourth question is also in favor of the Revenue and against the assessed.

71. The question of law referred to this court at the instance of the Department involves the interpretation of section 40(c) and section 40A(5) of the Act. There have been a number of amendments in the Act relating to these two provisions. In order to appreciate the full effect and scope of the said provisions, it will be helpful to refer to their legislative history in respect thereof.

72. Section 40(c) when enacted in the Income Tax Act, 1961, originally read as under :

"Notwithstanding anything to the contrary in sections 30 to 39, the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession". -

(a) in the case of any assessed -

(i) any interest chargeable under this Act, which is payable outside India (not being interest on a loan issued for public subscription before the 1st day of April, 1938), on which tax has not been paid or deducted under Chapter XVII-B and in respect of which there is no person in India who may be treated as an agent u/s 163;

(ii) any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains;

(iii) any payment which is chargeable under the head "Salaries", if it is payable outside India and if the tax has not been paid thereon nor deducted there from under Chapter XVII-B;

(iv) any payment to a provident or other fund established for the benefit of employees of the assessed, unless the assessed has made effective arrangements to secure that tax shall be deducted at source from any payment made from the fund which are chargeable to tax under the head "Salaries";

(b) in the case of any firm, any payment of interest, salary, bonus, commission or remuneration made by the firm to any partner of the firm;

(c) in the case of any company -

(i) any expenditure which results directly or indirectly in the provision of any remuneration or benefit or amenity to a director or to a person who has a substantial interest in the company or to a relative of the director or of such

person, as the case may be;

(ii) any expenditure or allowance in respect of any assets of the company used by any person referred to in sub-clause (i) either wholly or partly for his own purposes or benefit, if in the opinion of the Income Tax Officer any such expenditure or allowance as is mentioned in sub-clauses (i) and (ii) is excessive or unreasonable having regard to the legitimate business needs of the company and the benefit derived by or accruing to it there from [so, however, that the deduction in respect of the aggregate of such expenditure and allowance in respect of any one person referred to in sub-clause (i) shall in no case, exceed -

(A) where such expenditure or allowance relates to a period exceeding eleven months comprised in the previous year, the amount of seventy-two thousand rupees;

(B) where such expenditure or allowance relates to a period not exceeding eleven months comprised in the previous year, an amount calculated at the rate of six thousand rupees for each month or part thereof comprised in that period :

Provided that in a case where such person is also an employee of the company for any period comprised in the previous year, expenditure of the nature referred to in clauses (i), (ii), (iii) and (iv) of the second proviso to clause (a) of sub-section (5) of section 40A shall not be taken into account for the purposes of sub-clause (A) or sub-clause (B), as the case may be." Added with effect from 1-4-1972.

73. With effect from April 1, 1963, sub-clause (iii) was added to section 40(c) which is as under :

"(iii) any expenditure which results directly or indirectly in the provision of any remuneration or benefit or amenity to an employee who is a citizen of India to the extent such expenditure exceeds the amount calculated at the rate of five thousand rupees per month for any period of his employment after the 28th day of February, 1963 :

Provided that in computing the aforesaid expenditure, any payments by way of gratuity or any sums comprised in the transferred balance of a employee participating in a recognised provident fund referred to in clause (vii) of sub-section (1) of section 17, or the amount of any compensation referred to in clause (i), or any payment referred to in clause (ii) of sub-section (3) of that section shall not be taken into account."

74. The following sub-clause was substituted, in place of the above sub-clause (iii), by the Finance Act, 1964, with effect from April 1, 1964 :

"(iii) any expenditure incurred after the 29th day of February, 1964, which results directly or indirectly in the provision of any benefit or amenity or perquisite, whether convertible into money or not, to an employee (including any sum paid by the company in respect of any obligation which but for such

payment would have been payable by such employee), to the extent such expenditure exceeds one-fifth of the amount of salary payable to the employee for any period of his employment after the aforesaid date :

Provided that in computing the aforesaid expenditure any payment by way of gratuity or the value of any travel concession or assistance referred to in clause (5) of section 10 or passage moneys or the value of any free or concessional passage referred to in sub-clause (i) of clause (b) of that section or any sum referred to in clause (vii) of sub-section (1) of section 17 or in clause (v) of sub-section (2) of that section or the amount of any compensation referred to in clause (i) or any payment referred to in clause (ii) of sub-section (3) of that section or any payment referred to in clause (iv) or clause (v) of sub-section (1) of section 36 shall not be taken into account."

75. Further, the then existing Explanation was renumbered as Explanation 1 and, thereafter, Explanation 2 was inserted. [Explanation 2 was omitted by *ibid.*, with effect from 1-4-1969]. The so omitted Explanation was inserted by Act 5 of 1964, with effect from April 1, 1964, and stood as under :

Explanation 2. -In sub-clause (iii), the word "salary" shall have the meaning assigned to it in clause (h) of rule 2 of Part A of the Fourth Schedule."

76. With effect from April 1, 1969, sub-clause (iii) to section 40(c) was omitted and in its place, sub-clause (v) was added to section 40(a). The newly added sub-clause (v) is as under :

"(v) any expenditure which results directly or indirectly in the provision of any benefit or amenity or perquisite, whether convertible into money or not, to an employee (including any sum paid by the assessed in respect of any obligation which but for such payment would have been payable by such employee) or any expenditure or allowance in respect of any assets of the assessed used by such employee either wholly or partly for his own purposes or benefit, to the extent such expenditure or allowance exceeds one-fifth of the amount of salary payable to the employee, or an amount calculated at the rate of one thousand rupees for each month or part thereof comprised in the period of his employment during the previous year, whichever is less :

Provided that in computing the aforesaid expenditure or allowance, the following shall not be taken into account, namely :

- (a) any payment by way of gratuity;
- (b) the value of any travel concession or assistance referred to in clause (5) of section 10;
- (c) passages moneys or the value of any free or concessional passage referred to in sub-clause (i) of clause (6) of section 10;
- (d) any payment of tax referred to in sub-clause (vii) of clause (6) of section 10;

- (e) any sum referred to in sub-clause (vii) of clause (1) of section 17;
- (f) any sum referred to in sub-clause (v) of sub-clause (2) of section 17;
- (g) the amount of any compensation referred to in sub-clause (i) or any payment referred to in sub-clause (ii) of clause (3) of section 17; (h) any payment referred to in clause (iv) or clause (v) of sub-section (1) of section 36; and
- (i) any expenditure referred to in clause (ix) of sub-section (1) of section 36 :

Provided further that nothing in this sub-clause shall apply to any expenditure which results directly or indirectly in the provision of any benefit or amenity or perquisite to an employee whose income chargeable under the head "Salaries" is seven thousand five hundred rupees or less.

Explanation 1. -The provisions of this sub-clause shall apply notwithstanding that any amount not to be allowed under this sub-clause is included in the total income of the employee.

Explanation 2. - In this sub-clause, the word "salary" shall have the meaning assigned to it in clause (h) of rule 2 of Part A of the Fourth Schedule."

77. Section 40A was enacted with effect from April 1, 1968. By the Finance (No. 2) Act, 1971, sub-clause (v) of section 40(a) was omitted and sub-section (5) was inserted in section 40A. Sub-section (1) and sub-section (5) of section 40A with effect from April 1, 1972, are as under :

"40A. Expenses or payments not deductible in certain circumstances. -(1) The provisions of this section shall have effect notwithstanding anything to the contrary contained in any other provision of this Act relating to the computation of income under the head "Profits and gains of business or profession".

(5)(a) Where the assessed -

(i) incurs any expenditure which results directly or indirectly in the payment of any salary to an employee or a former employee, or

(ii) incurs any expenditure which results directly or indirectly in the provision of any perquisite (whether convertible into money or not) to an employee or incurs directly or indirectly any expenditure or is entitled to any allowance in respect of any assets of the assessed used by an employee either wholly or partly for his own purposes or benefit, then, subject to the provisions of clause (b), so much of such expenditure or allowance as is in excess of the limit specified in respect thereof in clause (c) shall not be allowed as a deduction :

Provided that where the assessed is a company, so much of the aggregate of -

(a) the expenditure and allowance referred to in sub-clauses (i) and (ii) of this clause; and

(b) the expenditure and allowance referred to in sub-clauses (i) and (ii) of clause

(c) of section 40, in respect of an employee or a former employee, being a director or a person who has a substantial interest in the company or a relative of the director or of such person, as is in excess of the sum of seventy-two thousand rupees, shall in no case be allowed as a deduction :

Provided further that in computing the expenditure referred to in sub-clause (i) or the expenditure or allowance referred to in sub-clause (ii) of this clause or the aggregate referred to in the foregoing proviso, the following shall not be taken into account, namely :

(i) the value of any travel concession or assistance referred to in clause (5) of section 10;

(ii) passage moneys or the value of any free or concessional passage referred to in sub-clause (i) of clause (6) of section 10;

(iii) any payment referred to in clause (iv) or clause (v) of sub-section (1) of section 36;

(iv) any expenditure referred to in clause (ix) of sub-section (1) of section 36.

(b) Nothing in clause (a) shall apply to any expenditure or allowance in relation to -

(i) any employee in respect of any period of his employment outside India;

(ii) any employee being an individual referred to in sub-clause (vii) or sub-clause (viiia) of clause (6) of section 10 in respect of any period during which he is entitled to the exemption under sub-clause (vii) or, as the case may be, sub-clause (viiia) aforesaid;

(iii) any employee whose income chargeable under the head "Salaries" is seven thousand and five hundred rupees or less.

(c) The limits referred to in clause (a) are the following, namely :-

(i) in respect of the expenditure referred to in sub-clause (i) of clause (a), in the case of an employee, an amount calculated at the rate of five thousand rupees for each month or part thereof comprised in the period of his employment in India during the previous year, and in the case of a former employee, being an individual who ceases or ceased to be the employee of the assessed during the previous year or any earlier previous year, sixty thousand rupees :

Provided that where the expenditure is incurred on payment of any salary to an employee or a former employee engaged in scientific research during any one or more of the three years immediately preceding the commencement of the business and such expenditure is deemed under the Explanation to clause (i) of sub-section (1) of section 35 to have been laid out or expended in the previous year in which the business is commenced, the limit referred to in this sub-clause shall, in relation to the previous year in which the business is commenced, be an amount calculated at the rate of five thousand rupees for each month or part

thereof comprised in the period of his employment in India during the previous year in which such business is commenced and in the period of his employment in India during which he was engaged in scientific research during the three years immediately preceding that previous year;

(ii) in respect of the aggregate of the expenditure and the allowance referred to in sub-clause (ii) of clause (a), one-fifth of the amount of the salary payable to the employee or an amount calculated at the rate of one thousand rupees for each month or part thereof comprised in the period of employment in India of the employee during the previous year, whichever is less.

Explanation 1. -The provisions of this sub-section shall apply notwithstanding that any amount not to be allowed under this sub-section is included in the total income of the employee or, as the case may be, the former employee.

Explanation 2. - In this sub-section, -

(a) "salary" has the meaning assigned to it in clause (1) read with clause (3) of section 17 subject to the following modifications, namely :-

(1) in the said clause (1), the word "perquisites" occurring in sub-clause (iv) and the whole of sub-clause (vii) shall be omitted;

(2) in the said clause (3), the references to "assessed" shall be construed as reference to "employee or former employee" and the references to "his employer or former employer" and "an employer or a former employer" shall be construed as a references to "the assessed";

(b) "perquisite" means -

(i) rent-free accomodation provided to the employee by the assessed;

(ii) any concession in the matter of rent respecting any accomodation provided to the employee by the assessed;

(iii) any benefit or amenity granted or provided free of cost or at concessional rate to the employee by the assessed;

(iv) payment by the assessed of any sum in respect of any obligation which, but for such payment, would have been payable to the employee; and

(v) payment by the assessed of any sum, whether directly or through a fund, other than a recognised provident fund or an approved superannuation fund, to effect an assurance on the life of the employee or to effect a contract for an annuity."

78. The contention on behalf of the Department is that, in the instant case, the provisions of section 40(c) are applicable and not section 40A(5), Some of the directors in the present case were employed outside India and, according to the assessed, the effect of section 40A(5)(b) was that the restriction of deduction to Rs. 72,000 did not apply because of employment outside India. Mr. Ahuja,

however, submitted that, in the case of a director who happened to be an employee, section 40(c) applied and not section 40A(5).

79. Reference was made by counsel for the parties to the various decision in which the two provisions have been considered.

80. The Gujarat High Court, in *Additional Commissioner of Income Tax, Gujarat Vs. Tarun Commercial Mills Ltd.*, , was concerned with the provisions of section 40(a)(v) (which was re-enacted as section 40A(5)) and section 40(c) of the Act. It was held by the High Court that section 40(a) applies to all assesseds and sub-clause (v) thereof dealt with the expenses for providing benefit, amenity or perquisite to the employees. On the other hand, clause (c) of the section dealt with the provision of benefit, amenity or perquisite to the directors of a company. Section 40(a)(v) was held to be a general provision, while section 40(c) was regarded as a particular enactment. The Gujarat High Court, Therefore, concluded that section 40(a)(v) will not be applicable to the directors of a company who are also employees of the company and only the provisions of section 40(c) would be applicable. This judgment was referred to by the Gujarat High Court in *Commissioner of Income Tax, Gujarat-I Vs. Bharat Vijay Mills Ltd.*, . The Gujarat High Court was, however, not concerned with the question as to whether section 40(c) or section 40A(5) applied which is the question which had arisen in *Additional Commissioner of Income Tax, Gujarat Vs. Rustam Jehangir Vakil Mills Ltd.*, . Therefore, the said decision can be of little assistance in the present case.

81. Another decision of the Gujarat High Court is that of *Commissioner of Income Tax Vs. Rajesh Textile Mills Ltd.*, . Referring to the aforesaid provisions, it was observed by the High Court at page 186 as follows :

"When section 40 is read in juxtaposition with section 40A, it becomes clear that section 40 operates notwithstanding anything contained to the contrary in sections 30 to 39, meaning thereby, that despite what might have been stated in the above-referred sections, the amount mentioned in section 40 shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession". So far as section 40A is concerned, it clearly lays down that the provisions of section 40A will have effect notwithstanding anything to the contrary contained in any other provision of this Act relating to the computation of income under the head "profits and gains of business or profession". Thus, the provisions of section 40A represent a special scheme of its own vis-a-vis computation of income under the said head. Once this aspect of the matter is kept in view, it becomes immediately apparent that the provisions of section 40A and its various sub-sections will have to be given full play while deciding the question whether certain expenses referred to in various clauses of section 40A have to be deducted or not while computing the income under the head "Profits and gains of business and profession"."

82. The Punjab and Haryana High Court in *Commissioner of Income Tax Vs.*

Patiala Flour Mills Co. (P.) Ltd., was concerned with the question of remuneration of an employee-director, but had no occasion to deal with the question as to whether section 40(c) applied or section 40A(5). It proceeded on the assumption that both the provisions applied and came to the conclusion that, in respect of a director or person having substantial interest in the company, the maximum amount which could be allowed was Rs. 72,000. Similar view was expressed by the Andhra Pradesh High Court in Commissioner of Income Tax Vs. D.B.R. Mills, . There again, the court had no occasion to consider a problem like the present, namely, whether section 40(c) applied or section 40A(5) in the case of working directors who were posted outside India.

83. In International Instruments (P.) Ltd. Vs. Commissioner of Income Tax, Karnataka, , the Karnataka High Court came to the conclusion that the first proviso to section 40A(5)(a) of the Act refers to expenditure incurred in respect of an employee or a former employee, being a director or a person who has a substantial interest in the company or a relative of the director or of such person. It does not, it was observed, like the proviso to section 40(c), speak of the period for which he was a director and, Therefore, section 40A(5) applied to an employee being a director during the whole year. This was held to be a special provision where the assessed is a company and where, inter alia, the person concerned is an employee being a director of the company. This case again was concerned with the question as to the limit of the remuneration which was allowable and the court had no occasion to deal with the question that where there is a conflict between section 40(c) and section 40A(5), which is the provision which will apply.

84. The view of the Gujarat High Court in Commissioner of Income Tax, Gujarat-I Vs. Bharat Vijay Mills Ltd., was dissented from by the Kerala High Court in Travancore Rayons Ltd. Vs. Commissioner of Income Tax, . A question arose, in that case, as to whether the expenditure arising or incurred in respect of a director of a company, who was also its employee during the relevant year, had to be deducted solely with reference to section 40A(5) and without regard to section 40(c). On behalf of the assessed, in that case, it had been contended that specific provisions contained in section 40(c) were applicable as much to a director as to director-employee, while the Revenue had contended that reference need be made only to section 40A(5). Dealing with the submissions and after referring to the relevant statutory provisions, the court was of the opinion that section 40 and section 40A could be read harmoniously and in respect of a director-employee, the company could claim deduction up to Rs. 72,000 but such claim was still subjected to the limitation in respect of salary and perquisites as provided by clauses (a) and (c) of sub-section (5) of section 40A.

85. In another case of Travancore Rayons Limited Vs. Commissioner of Income Tax, , the Kerala High Court followed its earlier decision and reiterated that the expenditure regarding the remuneration of a managing director of a company

could be allowed only with reference to section 40A(5) of the Act and that section 40(c) had no application.

86. Lastly, reference may be made to the decision of the Calcutta High Court in Commissioner of Income Tax Vs. Indian Molasses Co. (P.) Ltd., , where it was held, following the decision of the Gujarat High Court in Additional Commissioner of Income Tax, Gujarat Vs. Tarun Commercial Mills Ltd., , that a director of a company will be governed by the provisions of section 40(c), while other employees would be governed by the provision of section 40(a)(v) or section 40A(5), as the case may be. It was further held that section 40(c) was a special enactment, whereas section 40 which deals with the case of the employees was a general enactment.

87. The provisions of section 40 and section 40A of the Act show that repeated amendments have been made to the said provisions, from time to time, which has made the task of interpreting the said sections not easy. Nevertheless, we have tried to decipher the legislative process or thought in the enactment and amendment of these provisions which will throw light on their true import and effect. There are five distinct stages of enactment/amendment of these two provisions which are relevant to the present case, and these are as under :

1. In 1961, in the Act, section 40 was enacted. It contained no provision limiting the allowance of salary in the case of an employee. Disallowance could be made in the case of any expenditure of a company resulting directly or indirectly in making of any excessive or unreasonable provision for remuneration or benefit or perquisite to a director or a person who has a substantial interest in the company, etc.,

2. With effect from April 1, 1963, sub-clause (iii) was added to section 40(c) which, for the first time, brought in a restriction to the expenditure which resulted directly or indirectly in the making of provision of any remuneration benefit, etc., in the case of an employee in excess of stipulated amount. This sub-clause was amended in 1964 and continued to place a restriction on the amount of expenditure which is allowable as a deduction in relation to an employee.

3. With effect from April 1, 1968, section 40A was enacted.

4. With effect from April 1, 1969, sub-clause (iii) to section 40 was omitted and, in its turn, a similar provision was added to section 40(a) as sub-clause (v).

5. With effect from April 1, 1972, three changes were made in these two sections. Firstly, section 40(a)(v) was omitted, secondly section 40A(5) was inserted and, thirdly, the words "so, however, that the... as the case may be" were added at the end of section 40(c).

88. The picture which seems to emerge from the aforesaid enactment/amendments is that restriction with regard to the expenditure in connection with employees was first incorporated in section 40, when section 40 was enacted. This sub-clause, after it was amended in 1964, was omitted from section 40(c)

and was incorporated as sub-clause (v) in section 40. At that time, prior to April 1, 1972, section 40 contained a restriction with regard to the expenditure which could be allowed as a deduction by the way of remuneration, etc., incurred by a company in relation to a director or a person having substantial interest in a company. The case of the employees continued to be controlled by section 40(a) (v). Though section 40A was enacted with effect from April 1, 1968, it is only with effect from April 1, 1972, that the provision relating to the restriction of expenditure by way of salary to an employee was deleted from section 40 and was incorporated in section 40A, when sub-section (5) was added thereto. Reference was also made in section 40A(5) to "an employee or a former employee being a director or a person who has a substantial interest in the company..."

89. In our opinion, the legislative intent appears to be that the cases of the employees who were receiving salaries, whether they be directors or otherwise, are to be governed by section 40A whereas section 40, inter alia, related to remuneration and other benefits being provided to directors simpliciter. The very purpose of omitting section 40(a)(v), and, in its place, inserting section 40A(5) by including employee-directors therein, clearly shows that the legislative intent was that the question with regard to the allow ability of expenditure in connection with the employees was to be governed by section 40A and not section 40. This is further fortified by the fact that, as is evident from section 40A(1), the said section is to have an overriding effect notwithstanding anything to the contrary contained in any other provision of the Act. The non-obstante clause of section 40A(1) clearly means that even if there be any conflict between the provisions of section 40A and those of any other provision of the Act including section 40(c), the provisions of section 40A would prevail.

90. It would appear to us that section 40A(5) is a special provision and not a general one. Section 40A(5) relates only to employees whereas section 40 including section 40(c) would relate to all types of directors and other disallowances. Though employee-directors would, prior to April 1, 1972, have been covered by the provisions of section 40(c), after the enactment of section 40(a)(v) and because of the non-obstante provisions of section 40A(1), it is section 40A(5), and not section 40(c), which will apply in the case of employee-directors. One of the reasons which compels us to come to this conclusion, at least in the present case, is that section 40A(5)(b) specifically deals with the question of an employee who is in employment outside India. When reference is made in section 40A to the provisions of clause (a) of section 40A(5), it would obviously mean that reference is also made to the employee-directors who are employed outside India. Section 40(c) does not deal with cases of employees employed outside India. That situation is dealt with only u/s 40A(5). Therefore, even if it be assumed, for the sake of argument, that section 40A is general and section 40(c) is specific qua the directors, nevertheless, in respect of employee-directors who are posted outside India, section 40(c) cannot and does not apply. Section 40(c) does not envisage the case of an employee-director who is posted

out of India. Such a case is dealt with only by section 40A(5)(b). This being so, at least qua employee-directors employed outside India, section 40A(5)(b) is a specific provision and section 40(c) has to be regarded as a general provision. On the principle that, if there is a general provision and there is also a special provision, then it is the special provision which will prevail, the only conclusion to which we can come in the present case is that the case of remuneration of employee-directors of the assessed-company falls under the provisions of section 40A(5) and not section 40(c).

91. For the aforesaid reasons, this question is answered in the affirmative and against the Revenue.

92. The reference is answered accordingly. There will be no order as to costs. By a separate order passed today in Income Tax References Nos. 110 to 112 of 1987, we have answered the questions of law partly in favor of the assessed and partly in favor of the Department.

93. The question which arises in this case at the instance of the assessed pertains to the interpretation of section 80HBB and section 80O of the Income Tax Act. Whether the case of the assessed falls u/s 80O or section 80HBB is the principal question and the other questions have also been argued before us and dealt with by us. There is no decision of any court whereby the said provisions have been compared. There are a large number of Indian entrepreneurs who are executing projects outside India and such questions are likely to arise in a number of cases and are of general public importance. In our opinion, this is a fit case where question Nos. 1 to 3 should be certified as fit for being appeal to the Supreme Court.

94. As far as question No. 4 is concerned, the same is already covered by a decision of this court which had held that a company, like the assessed, would not be regarded as an industrial company. Against the said earlier decision, a SLP has been filed, which was allowed and an appeal is pending. This being so, we will certify question No. 4 also as being a fit one for appeal to the Supreme Court.

95. Coming to the question which has been referred at the instance of the Department, the same relates to the interpretation of section 40(c) and section 40A of the Income Tax Act. We find that there has been a divergence of opinion amongst the different High Courts in India. The Gujarat High Court has taken one view, whereas the Kerala High Court has taken a different view. There is no decision of the Supreme Court on the point in issue and, Therefore, we feel that is also a fit question which has to be certified as being a fit one for appeal to the Supreme Court.

96. For the aforesaid reasons, we allow the oral prayers of counsel for the parties and grant a certificate as contemplated by section 261 of the Income Tax Act read with article 133 of the Constitution of India to both the parties to file appeals.