(1996) 09 MAD CK 0055

In the Madras High Court

Case No : Writ Petition No''s. 2072 and 2073 of 1987

Indian Commerce and Industries Co. Pvt. Ltd. — APPELLANT

Vs

Inspecting Assistant Commissioner of Income Tax and another — RESPONDENT

Date of Decision : 20-09-1996

Acts Referred:
Income Tax Act, 1961 — Section 119(1), 256, 80(HHB(1)), 80(HHB(5)), 80(HHB)

Citation : (1998) 229 ITR 335

Hon'ble Judges : Kanakaraj, J

Bench : Single Bench

Advocate : P.P.S. Janardhana Raja, for the Appellant; S.V. Subramanian, for the Respondent

Judgement

Kanakaraj, J.—These two writ petitions filed by the same petitioner raise the same question in respect of the two assessment years, namely,

1983-84 and 1984-85. W.P. No. 2073 of 1987 seeks a writ of certiorarified mandamus to quash the order of the second respondent dated

December 15, 1986, and to direct the second respondent to grant relief to the petitioner u/s 80-O of the Income Tax Act, 1961 (hereinafter called

the Act""), for the assessment year 1983-84. Similarly, W.P. No. 2072 of 1987 seeks to quash the order dated December 15, 1986, and to grant

relief to the petitioner u/s 80-O of the Act for the assessment year 1984-85. The common order dated December 15, 1986, is cryptic and is as

follows :

I am directed to refer to your petition dated November 26, 1986, personally presented by Shri R. S. Manian to the Member (Central Board of

Direct Taxes) on your behalf on the above subject and to say that, as already explained to your representative, in view of the provisions in sub-

sections (1)(b) and (5) of section 80HHB of the Act, the application u/s 80-O was rejected and no review lies in the matter.

2. The petitioner is a company registered under the Indian Companies Act, 1956, having its registered office at Madras. The petitioner-company

has acquired experience in the erection of structural steel work and they are in possession of complete technical know-how relating to estimation

checking of centre lines in foundations and certain preliminary works like setting, assembling and field-welding prior to the erection of structural

steel work. For the assessment year 1983-84, the petitioner filed a return of income on June 30, 1983, showing an income of Rs. 4,23,963. The

first respondent determined the total income at Rs. 4,68,593. The first respondent disallowed the claim of the petitioner u/s 80-O of the Act on the

ground that the agreement with the foreign company, Emirates Trading Agencies, had not been approved by the second respondent, the Central

Board of Direct Taxes (hereinafter called ""the Board""). For the year 1984-85, the petitioner had returned an income of Rs. 6,71,340. The first

respondent determined the total income at Rs. 6,79,201. In this case also the claim u/s 80-O of the Act had been disallowed on the ground that

the agreement had not been approved by the Board.

3. The petitioner had entered into an agreement with the Emirates Trading Agencies, Dubai, UAE, on March 26, 1981. Clauses 1 and 4 of the

agreement alone are relevant for the purpose of the writ petitions. Clause 1 is as follows :

Clause 1. Consultants services. - The consultants shall impart the technical know-how engineering and advice for the following works to be

carried out by the client in connection with and with regard to the said work involving erection of about 130 m.t. of structural steel work.

(a) Working out estimates for setting, assembling and field welding, if any, for erection of fabricated structural steel work;

(b) Preparation of shop drawings, if any;

(c) Checking of centre lines in foundations at site with reference to structural steel shop drawings;

(d) Setting, assembling and field-welding, if any, prior to erection at site as per the steel work drawings;

(e) Advising manpower requirements and organising of site erection;

(f) Erection of structural steel work at site including quality control.

Clause 4 of the agreement deals with method of payment which reads as follows :

Clause 4 : Method of payment. - The clients shall pay the said fees to the consultants in stages as below :

(a) 25 per cent. as advance;

(b) 25 per cent. as soon as foundation centres are checked;

(c) 25 per cent. on assembly and commencement of erection;

(d) 25 per cent. on erection.

4. The petitioner filed an application on April 8, 1982, to the Board seeking approval of the agreement u/s 80-O of the Act. It is the case of the

petitioner that similar agreements had earlier been approved by the Board. In the said application dated April 8, 1982, the petitioner sought

approval for the assessment year 1982-83 and the subsequent assessment years. On March 21, 1984, the Board issued a show-cause notice as

to why the application should not be rejected for the assessment year 1982-83 and onwards. The petitioner sent all the necessary details relating to

the agreement. On March 19, 1986, a communication was received stating that the Board regretted its inability to approve the agreement for the

purpose of section 80-O of the Act. The reasons given in the order state that all or any of the activities under the abovesaid agreement involved the

execution of a foreign project or work forming part of the foreign project described in section 80HHB of the Act, and, therefore, they are not

activities covered by section 80-O of the Act. In particular, reference was made to sub-section (5) of section 80HHB which disentitles the

assessee from claiming any deduction u/s 80-O of the Act. The petitioner filed another application to the Board on August 1, 1986, to reconsider

the matter. The Board again passed an order on October 6, 1986, rejecting the petition. A second review petition was filed on November 26,

1986, and the impugned order dated December 15, 1986, came to be passed. The contention of the petitioner is that section 80HHB of the Act

does not apply to the facts of the petitioner''s case and the Board is bound to consider the claim of the petitioner u/s 80-O of the Act. It is the

further contention of the petitioner that so long as the salient requirements of section 80-O are satisfied the Board cannot shirk its responsibility to

consider the claim for approval u/s 80-O of the Act. A contention is also raised in the affidavit that sub-section (5) of section 80HHB of the Act

cannot affect existing contracts entered into much earlier to the introduction of section 80HHB of the Act. In this connection, it has to be

remembered that section 80HHB of the Act came into force with effect from April 1, 1983.

5. In answer to the points raised in the affidavits of the petitioner a counter-affidavit has been filed by the respondents. It is pointed out that the

order dated March 19, 1986, rejecting the petition for approval gives the correct reasons and the subsequent orders are only based on the first

order dated March 19, 1986. The reason is that all or any of the activities under the subject agreement involved the execution of a foreign project

or work forming part of a foreign project as described in section 80HHB of the Act and, hence, it was not an activity covered by section 80-O of

the Act. In particular, in view of sub-section (5) of section 80HHB no part of the consideration would qualify for deduction u/s 80-O of the Act.

Reference has been made to the judgment of the Supreme Court in M/s. Continental Construction Ltd. Vs. Commissioner of Income Tax, Central-

I, . It is also pointed out that the fact that similar agreements had been earlier approved, is not relevant or germane because the Act was amended

with effect from April 1, 1983, by introducing section 80HHB of the Act.

6. Learned counsel for the petitioner argues that any number of petitions can be filed before the Board for approval of an agreement u/s 80-O of

the Act. He, therefore, argues that the mere fact that the earlier order of the Board dated March 19, 1986, was not challenged would not be a bar

to challenging the last order of the Board dated December 15, 1986, which in terms confirms the earlier order dated March 19, 1986. I do not

think that the petitioner can be declined relief if otherwise eligible on the above technical ground. The court has to go into the substance of the

matter, namely, whether the refusal to approve the agreement u/s 80-O of the Act is proper and justified. The court has to keep in mind the fact

that the order of the assessing authority is not challenged. But it is only the order of the Board which is challenged. In other words, the petitioner

only wants a reconsideration of the application for approval and a direction that the petitioner is entitled to the approval for the two assessment

years 1983-84 and 1984-85. Once the petitioner gets an approval, the assessee can work out his rights in respect of the assessment orders. The

question whether the order of approval by the Board will have an effect on the scope of assessment by the assessing authority, is also indirectly

involved in this case. In my opinion, the court cannot blindly direct the Board to consider the claim of the assessee purely on a consideration of the

applicability of the requirements u/s 80-O of the Act. Learned counsel for the petitioner says that the law is settled with reference to the two

provisions, i.e., under sections 80-O and 80HHB of the Act, by the judgment of the Supreme Court i M/s. Continental Construction Ltd. Vs.

Commissioner of Income Tax, Central-I, . He draws my attention to the following passage in the said decision (page 119) :

... it is sufficient for us to point out that it is a well-settled principle that exigibility of an item to tax or tax deduction can hardly be made to depend

on the label given to it by the parties. As assessee cannot claim deduction u/s 80-O in respect of certain receipts merely on the basis that they are

described as royalty, fee or commission in the contract between the parties. By the same token, the absence of a specific label cannot be

destructive of the right of an assessee to claim a deduction, if, in fact, the consideration for the receipts can be attributed to the sources indicated in

the section.

7. The Supreme Court also observed as follows (page 120) :

We are, therefore, of the opinion that, if, as we have held, the contracts in the present case oblige the assessee to make available information and

render services to the foreign Government of the nature outlined in section 80-O, it is the duty of the Revenue and the right of the assessee to see

that the consideration paid under the contract legitimately attributable to such information and services is apportioned and the assessee given the

benefit of the deduction available under the section to the extent of such consideration.

8. Reliance is next placed on Stup Consultants Ltd. Vs. Central Board of Direct Taxes and others, . The facts of the said case are almost identical

with the facts of the present case. A single judge of the Bombay High Court was considering the validity of an order of the Board refusing to approve certain agreements u/s 80-O of the Act merely on the ground that the agreement fell within section 80HHB of the Act and, therefore,

were out of the ambit of section 80-O of the Act in view of sub-section (5) of section 80HHB of the Act. The learned judge was of the following

view (page 357) :

However, the Legislature has given jurisdiction to administer and apply section 80HHB to the Assessing Officer, whereas the jurisdiction to

approve the agreements u/s 80-O vests in the Board. If the Board exercises jurisdiction u/s 80-O by considering the provisions of section 80HHB,

the applicant will have no right to challenge the order of the Board by way of appeal or reference. The applicant will be placed in an unenviable

position. On the other hand, if the Board considers the application for approval from the point of view of the conditions laid down in section 80-O

and leaves it to the Assessing Officer whether or not a part or the whole of the income under the agreement also falls u/s 80HHB so as to deprive

him of the benefit u/s 80-O, the assessee will not be prejudiced inasmuch as he, then, will have a right of appeal and reference, etc.

9. This judgment was rendered on September 17, 1990. The same learned judge had rendered an identical decision on September 19, 1990, in

K.M.A. International Ltd Vs. Central Board of Direct Taxes and others, . Observed the Bombay High Court (page 339) :

In the above view of the matter, in my judgment, it is only appro.priate that the Board continues to consider the agreements in question purely

from the point of view of section 80-O and grant or refuse approval on that basis. The Board may, if so advised, qualify the approval by making it

clear that it will be open to the Assessing Officer to examine whether the whole or part of the income under the agreement falls u/s 80HHB(1), so

as to disentitle such income from the benefit u/s 80-O. Because, if the Board refuses to approve the agreement, no Assessing Officer will grant

relief u/s 80-O.

10. In my opinion, there is one other judgment of the Bombay High Court rendered by a Division Bench in Blue Star Limited Vs. Central Board of

Direct Taxes and others, . This judgment was rendered on August 26, 1992, after the judgment of the Supreme Court in M/s. Continental

Construction Ltd. Vs. Commissioner of Income Tax, Central-I, . A circular issued by the Board on December 23, 1975, (see Commissioner of

Income Tax Vs. P.N. Nagaraj and Another, , and modified by a further circular dated April 30, 1979 (see [1980] 126 ITR 21, was relied upon

for the proposition that the Board may not approve an agreement for the purposes of section 80-O, 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 which qualify u/s 80-O of the Act.

11. The circular says (page 864) :

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 80-O, can be exempted.

12. The Bombay High Court has further observed that the Supreme Court in M/s. Continental Construction Ltd. Vs. Commissioner of Income

Tax, Central-I, , had indicated that the circular would not deprive the Assessing Officer of all functions while making the assessment on the

applicant. The relevant passage in the Supreme Court judgment is extracted in support of the ultimate decision rendered by the Bombay High

Court. The Bombay High Court had referred the matter back to the Central Board to dispose of the case in the light of their own judgment, the

judgment of the Supreme Court and the said circular.

13. On the other hand, learned counsel for the Revenue placed considerable reliance on the judgment of the Supreme Court in M/s. Continental

Construction Ltd. Vs. Commissioner of Income Tax, Central-I, . Instead of relying on the judgment of the Supreme Court in a piece-meal fashion,

I am of the opinion that it will be proper to take note of the entire judgment for appreciation of the principles laid down by the apex court. The

apex court was concerned with regular orders of assessment and questions of law referred u/s 256 of the Income Tax Act. Further, there were as

many as eight agreements before the apex court of which, we are probably concerned only with the seventh and the eighth agreements dated

December 17, 1980, and January 10, 1981. In respect of these agreements, the Board had granted approval u/s 80-O of the Act on the following

terms (page 94) :

For the assessment year 1982-83. For the subsequent period your attention is invited to the provisions of section 80HHB which are operative

with effect from April 1, 1983.

14. The Supreme Court has observed that after April 1, 1987, both sections 80HHB and 80-O of the Act permit a deduction from the gross total

income of 50 per cent. of the profits in the one case and all the qualifying receipts in the other. The Supreme Court also takes note of the fact that

prior to April 1, 1987, the relief under the two different sections was totally different. While u/s 80HHB only 25 per cent. of the profits were

eligible for exemption, the deduction u/s 80-O of the Act, was 100 per cent. of the qualifying receipts, up to the assessment year 1984-85. This is

precisely the reason why in the present case learned counsel for the petitioner is urging for quashing of the Board''s order and for reconsideration

of the same in the light of the judgment of the Bombay High Court. The Supreme Court then considered the question of the approval granted by

the Board vis-a-vis the judgment in The Commissioner of Income Tax, Delhi-1, New Delhi Vs. Indian Institute of Public Opinion Co. (Pvt.) Ltd., .

In other words, once the Board approves a contract u/s 80-O in relation to the first assessment year, approval ensures for the entire duration of

the contract. Even so, observed the Supreme Court (page 125) :

The Board''s approval of the contract - in 1983 as well as 1985 - has no doubt this effect. But this is not the same thing as saying that relief u/s

80-O would be available despite section 80HHB.

15. After observing that the Board has only to approve an agreement and the approval cannot be hedged in with conditions and restrictions the

Supreme Court pointed out (page 126) :

The position, therefore, is that the Board''s approval of the agreements in the present case, originally accorded legitimately and properly, as

pointed out by us, in respect of assessment years earlier to 1983-84 would enable the assessee to claim like relief u/s 80-O, for all subsequent

years too. But, after the insertion of section 80HHB, in the matter of receipts governed both by section 80HHB and section 80-O, the former and

not the latter would prevail. We have, therefore, come to the conclusion that the July 31, 1985, amendment of the Board''s approval cannot help

the assessee to overcome the mandate of section 80HHB(5).

16. The Supreme Court then took up for consideration the scope and effect of the approval granted by the Board to the terms of a contract u/s

80-O of the Act. There were rival submissions on the above point. Observed the Supreme Court (page 130) :

While, at one time, the Income Tax Officer was described as the king-pin of the tax administration and was the sole repository of all functions

pertaining to assessment, the recent tendency has been to vest powers of assessment even in officers above the rank of the Income Tax Officer

either because of the amount involved or for other reasons.

17. On the said issue, the Supreme Court held (page 131) :

In this situation, we find it difficult to accept the plea of Sri Ahuja that the approval is nothing but a measure for screening the cases which an

Assessing Officer may have to consider.

It is only thereafter the Supreme Court referred to the circulars issued by the Board and rendered the passage which was quoted by the Bombay

High Court in Blue Star Limited Vs. Central Board of Direct Taxes and others, , for remanding the case back to the Board. That passage is as

follows (page 132 of 195 ITR) :

It is thus clear that the Board has chalked out for itself, we think quite legitimately and properly, a very detailed and dominant role as to the

availability of exemptions u/s 80-O. The guidelines are of general nature, fully sanctioned by the provisions of section 119(1) of the Act and, being

instructions ensuring to the benefit of the assessee, cannot be gone back upon by the Departmental Officers subordinate to the Board, particularly

in a case where no steps have been taken - or even suggested as necessary to be taken - to cancel or revoke the approval already accorded.

With reference to the facts of the present case the following observation of the Supreme Court are also apposite (page 133 of 195 ITR) :

We may in this context, also point out that, while the Board, in the present case, simply approved some of the contracts on the basis of the

application filed, it has, in the case of some other contracts, modified that basis also. For instance, in regard to the Wadi Khan and Abu Sukhair

Projects, the letter of approval states that approval is granted subject to the condition or clarification that only the profits relating to rendering of

technical services would qualify for the benefit of section 80-O of the Income Tax

Act and not the profits relating to the supply of

material/equipment. These guidelines have also since attained statutory recognition as the pro forma earlier prescribed by the Board has virtually

been incorporated in rule 11E and the form prescribed thereunder.

The Supreme Court also observed that the above conclusions on the scope of the Board''s approval did not mean (at page 133) ""the deprivation

of all functions of the Assessing Officer while making the assessment on the applicant. The officer has to satisfy himself (i) that the amounts in

respect of which the relief is claimed are amounts arrived at in accordance with the formula, principle or basis explained in the assessee''s

application and approved by the Board, (ii) that the deduction claimed in the relevant assessment year relates to the items, and is referable to the

basis, on which the application for exemption was asked for and granted by the Board; (iii) that the receipts (before the 1975 amendment) were

duly certified by an accountant or that, thereafter, the amounts have been received in or brought into India in convertible foreign exchange within

the specified period"". What is more, the Supreme Court proceeded to observe (page 134) :

The first is that the jurisdiction of the Board is to grant approval to a contract only for the purposes of section 80-O; it has no jurisdiction to

pronounce on the availability or otherwise of the exemption u/s 80HHB and the Board''s opinion as to this, even if expressly stated by the Board,

cannot bind the officer. The relief u/s 80HHB is not dependent on the approval of the Board and is for a totally different type of transaction.

18. Ultimately, the Supreme Court held in that case that the assessee was entitled to relief u/s 80-O of the Act for the assessment years earlier to

1983-84 and the approvals granted by the Board were right and proper. But, in respect of the assessment year 1983-84, the Supreme Court

categorically held that the assessee did not qualify for deduction in view of section 80HHB and that sub-section (5) of section 80HHB would

prevail over the relief that might have been otherwise available to the assessee. It has to be remembered that the above judgment of the Supreme

Court was rendered on the facts before them wherein approval had been granted to the assessee and the reliefs were granted on the basis of the

correctness of such approvals. In the case before us, the assessee is pleading for a reconsideration of his approval petition.

19. In my opinion, the observation of the Supreme Court relating to the scope of the Board''s power vis-a-vis the power of the assessing authority

and the importance given to the circulars regarding the guidelines that should be followed by them while granting or rejecting an application for

approval should be kept in mind before considering the validity of the orders impugned in these two writ petitions. The Board has clearly stated

that in the case of composite agreements ""approval would be granted by the Board subject to suitable disallowance for non-qualifying services,

after taking into consideration the totality of the agreement so that the balance of royalty/fees, etc., which is for the services covered by section 80-

O, could be exempted."" All that the petitioner is pleading for in this case is the above consideration by the Board. This is precisely what the

Division Bench of the Bombay High Court had also indicated in their judgment dated August 26, 1992, in Blue Star Limited Vs. Central Board of

Direct Taxes and others, .

20. Learned counsel for the respondents, however, sought to argue that the Board had in fact pointed out in their letter dated June 21, 1984, that

out of the works undertaken by the petitioner-company, clauses (d), (e) and (f) clearly involved erection of work covered by section 80HHB. The

petitioner was called upon to intimate the part of fees attributable to those clauses, namely (d), (e) and (f). Therefore, it is argued that the petitioner

has to blame himself for not giving the correct particulars. This is easily answered by learned counsel for the petitioner by adverting to their letter

dated June 28, 1984. In this letter, it is reiterated that the company has to render only consultancy services for imparting engineering know-how

and advise on the three clauses (d), (e) and (f). They also pointed out that they did not undertake to do any physical work in the erection of the

130 m.t. structural steel work. In view of the above correspondence the question is whether the impugned order can be sustained. To recapitulate

the facts, the impugned order simply says that in view of sub-section (5) of section 80HHB, the application u/s 80-O was being rejected. Even if

we take the first order dated March 19, 1986, it only says that all or any of the activity under the above mentioned agreement involved the

execution of a foreign project or work forming part of a foreign project as described in section 80HHB of the Act. I am of the opinion that the

above orders of the Board do not conform to their own circulars quoted by the Supreme Court of India in M/s. Continental Construction Ltd. Vs.

Commissioner of Income Tax, Central-I, , followed by the Bombay High Court in Blue Star Limited Vs. Central Board of Direct Taxes and

others, . Having regard to the importance given to the Board and the scope of its order of approval, by the Supreme Court of India, something

more and better is expected from the Board while considering a composite agreement for which approval is sought for. In this case, I have already

extracted clauses 1 and 4 of the agreement. Clause 1 says that only technical know-how was being imparted in respect of certain types of work.

But there are certain clauses which do indicate that the company is expected to do something more than mere imparting of technical know-how,

Therefore, the Board should have given opportunity to the petitioner to explain in person the actual services rendered by them and whether any

part of the service comes out of section 80-O of the Act and whether in respect of that part approval could have been granted. To this extent, I am

satisfied that the impugned orders have to be quashed and they are remitted back to the Board for passing fresh orders after giving fresh

opportunity to the petitioner to explain their whole case with reference to sections 80-O and 80HHB of the Act. In this view of the matter, the writ

petitions are allowed and the impugned orders are quashed. The respondents are directed to pass fresh orders on the application of the petitioner

for approval of the agreement dated March 26, 1981, in the light of the observations contained in this judgment. There will, however, be no order

as to costs.

