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**(2014) 12 DEL CK 0047**

**In the Delhi High Court**

**Case No :** ITA No. 588/2013

Ramsons Organics — APPELLANT

Vs

Commissioner of Income Tax — RESPONDENT

**Date of Decision :** 12-12-2014

**Acts Referred:**
Income Tax Act, 1961 — Section 10B, 10B(4), 139, 260A, 36(1)(vii)
Industries (Development and Regulation) Act, 1951 — Section 14

**Citation :** (2015) 1 AD 398

**Hon'ble Judges :** V. Kameswar Rao, J;Sanjiv Khanna, J

**Bench :** Division Bench

**Advocate :** Rakesh Gupta and Rishabh Kapoor, Advocate for the Appellant; Ruchir Bhatia and Akash Vajpai, Advocates for Rohit Madan, Sr. Standing Counsel, Advocate for the Respondent

## Judgement

Sanjiv Khanna, J.—This appeal by the assessee under Section 260A of the Income Tax Act, 1961 (Act, for short) relates to assessment year 2005-06 and was admitted for hearing vide order dated 7th July, 2014 on the following substantial question of law:-

"Whether on the facts and in the circumstances of the case, the Hon''ble Tribunal has erred in law in wrongly interpreting section 10B and thus allowing the deduction u/s. 10B less by Rs. 25,33,078/-?"

2. The impugned order passed by the Income Tax Appellate Tribunal (Tribunal, for short) is dated 28th June, 2013.

3. The appellant-assessee is a 100% export oriented unit and during the period relevant to the assessment year 2005-06, it had total export turnover of Rs. 14.87 crores (FOB value). The appellant-assessee had earned profit of Rs. 2,86,57,967/-. The assessee had not received export proceeds of Rs. 6,56,828/- from M/s. Hermann Vertriebs GmbH and of Rs. 18,76,250/- from M/s. Pangea Import Group Inc. during the year in question or during the extended period of

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six months as permitted by the Reserve Bank of India. In the assessment order, it was observed that Rs. 25,33,078/- were treated bad debt by the appellant-assessee and accordingly the profits for the purpose of claim for deduction under Section 10B of the Act should be reduced from the profit as declared. The Assessing Officer, however, made the computation under Section 10B of the Act in the following manner:-

"2.2) On perusal of the details filed it is sent that the following payments were receivable and the same had been written off by the assessee.

1. Hermann vertriebs Gmbh 6,56,828/- write off in 2008-09.

2. Pangea Import Group INC. 18,76,250/- write off in 2007-08.

As the assessee has written off Rs. 25,33,078/-, the same treated as bad debt. The 10B claimed shall be restricted to amount realized with-in the stipulated time.

2.3) Total income of assessee is computed as under:

Total Income as per computation filed

2,86,85,967/-

Less Income treated as bad debt (as discussed in Para 2.2)

25,33,078/-

Add: foreign exchange fluctuation per Para 1.3

17,11,170/-

2,78,64,059/-

Less exemption u/s 10B restricted to export realization

(Rs. 2,86,57,967/-(-) 25,33,078/-) = 2,61,24,889/-

2,61,24,889/-

Gross Total Income

17,39,170/

Less deduction u/s 80G as claimed in original return.

6,500/-

TOTAL INCOME

17,32,670/-?

Thus, for computation of deduction under Section 10B of the Act, Rs. 25,33,078/- were treated as bad debt and also reduced from the profit earned. The computation, therefore, did not impact the quantum of deduction.

4. In the first appeal, the assessee raised a ground that Rs. 25,33,078/- should

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not be treated as bad debt relatable to the Assessment Year 2005-06. The submission was that the two amounts totalling Rs. 25,33,078/- were not written off as bad debt in the year in question, but had been written off in the assessment years 2008-09 and 2007-08. Accordingly, they would impact the profits for the assessment years 2008-09 and 2007-08, without affecting the profits of the current year, i.e. the assessment year 2005-06. The Commissioner of Income Tax (Appeals) rejected the said contention, observing:-

"6.1 I have carefully considered the assessment order and the submission made by the Id. AR on the above issue. As per the facts of this case, the appellant has claimed deduction u/s. 10B in respect of export sales. As per the assessment order, out of the said export sales pertaining to this year, Rs. 6,56,828/- and Rs. 18,76,250/- in respect of two parties, viz. M/s. Hermann Vertriebs Gmbh and M/ s. Pangea Import Group Inc respectively were not realized by the appellant company during this year or during the extended period of six months permitted by RBI. The AO has also observed that the above two amounts of Rs. 6,56,828/- and Rs. 18,76,250/- have been written off by the appellant company subsequently in A.Ys. 2008-09 and 2007-08 respectively. The AO has reduced the exemption u/s. 10B by Rs. 25,33,078/- (Rs. 6,56,828/- plus Rs. 18,76,250/-) on account of non-realisation of the export proceeds. I find this action of the AO to be valid and confirm the above disallowance of Rs. 25,33,078/- u/s. 10B."

5. The Commissioner of Income Tax (Appeals) also issued notice to the assessee, as he felt that Rs. 25,33,078/- should be added to the profit earned. The assessee filed response but the same was not accepted for the reasons set out in paragraph 6.2.2. For the sake of convenience, paragraph 6.2.2 is reproduced below:-

"6.2.2 On careful examination of the matter, I find that the above submissions of the appellant are not relevant to the issue at hand. It is undisputed fact that the above two amounts totaling Rs. 25,33,078/- related to exports made during the current year. The appellant could have received the above amount during the current year or during the extended period of six months for the purpose of section 10B, or even thereafter without the benefit of section 10B. Therefore, there is no reason as to why the above amount should be treated as bad debt during the year under consideration. Further, significantly the appellant itself has not written off the above amounts as bad debts in its books of account during the current year. In fact, such write off has been made by the appellant much later, i.e. only in A.Ys. 2008-09 and 2007-08. Accordingly, I find that the said amount cannot be allowed as bad debt during the current year as per the provisions of section 36(1)(vii) read with section 36(2) of the Act. The AO is, therefore, directed to add the above amount of Rs. 25,33,078/- to the appellant''s income for this year and the income of the appellant is enhanced by the above amount."

6. The appellant-assessee thereafter filed an appeal before the Tribunal which stands dismissed by the impugned order recording the following reasons:-

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"6.2 We have heard both the sides, considered the materials on record and find that except taking the plea that Ld. CIT(A) has grossly erred in reducing the deduction under section 10B of the Income-tax Act, 1961 by Rs. 25,33,078/- without understanding the provisions of Income-tax Act, 1961 and circular of RBI in this regard, assessee''s AR has not explained further as to how the order of Ld. CIT(A) is not justified. Considering the entirety of facts, circumstances of the case and material on record, we have no option but to confirm the order of the Ld. CIT(A) which is confirmed and only ground in appeal of the assessee is dismissed."

7. In order to appreciate the controversy, we would like to reproduce relevant portions of Section 10B:

"10B. Special provisions in respect of newly established hundred per cent export-oriented undertakings.-?(1) Subject to the provisions of this section, a deduction of such profits and gains as are derived by a hundred per cent export-oriented undertaking from the export of articles or things or computer software for a period of ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or things or computer software, as the case may be, shall be allowed from the total income of the assessee:

Provided that where in computing the total income of the undertaking for any assessment year, its profits and gains had not been included by application of the provisions of this section as it stood immediately before its substitution by the Finance Act, 2000, the undertaking shall be entitled to the deduction referred to in this sub-section only for the unexpired period of aforesaid ten consecutive assessment years:

Provided further that for the assessment year beginning on the 1st day of April, 2003, the deduction under this sub-section shall be ninety per cent of the profits and gains derived by an undertaking from the export of such articles or things or computer software:

Provided also that no deduction under this section shall be allowed to any undertaking for the assessment year beginning on the 1st day of April, 2012 and subsequent years:

Provided also that no deduction under this section shall be allowed to an assessee who does not furnish a return of his income on or before the due date specified under sub-section (1) of section 139.

(2) xxx

(3) This section applies to the undertaking, if the sale proceeds of articles or things or computer software exported out of India are received in, or brought into, India by the assessee in convertible foreign exchange, within a period of six months from the end of the previous year or, within such further period as the competent authority may allow in this behalf.

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Explanation 1.--For the purposes of this sub-section, the expression "competent authority" means the Reserve Bank of India or such other authority as is authorised under any law for the time being in force for regulating payments and dealings in foreign exchange.

Explanation 2.--The sale proceeds referred to in this sub-section shall be deemed to have been received in India where such sale proceeds are credited to a separate account maintained for the purpose by the assessee with any bank outside India with the approval of the Reserve Bank of India.

(4) For the purposes of sub-section (1), the profits derived from export of articles or things or computer software shall be the amount which bears to the profits of the business of the undertaking, the same proportion as the export turnover in respect of such articles or things or computer software bears to the total turnover of the business carried on by the undertaking.

xxx

Explanation 1.-- [Omitted by the Finance Act, 2003, w.e.f. 1-4-2004.]

Explanation 2.--For the purposes of this section,--

(i) "computer software" means--

(a) any computer programme recorded on any disc, tape, perforated media or other information storage device; or

(b) any customized electronic data or any product or service of similar nature as may be notified by the Board, which is transmitted or exported from India to any place outside India by any means;

(ii) "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 thereunder or any other corresponding law for the time being in force; (iii) "export turnover" means the consideration in respect of export by the undertaking of articles or things or computer software received in, or brought into, India by the assessee in convertible foreign exchange in accordance with sub-section (3), but does not include freight, telecommunication charges or insurance attributable to the delivery of the articles or things or computer software outside India or expenses, if any, incurred in foreign exchange in providing the technical services outside India;

(iv) "hundred per cent export-oriented undertaking" means an undertaking which has been approved as a hundred per cent export-oriented undertaking by the Board appointed in this behalf by the Central Government in exercise of the powers conferred by section 14 of the Industries (Development and Regulation) Act, 1951 (65 of 1951), and the rules made under that Act;

(v) "relevant assessment years" means any assessment years falling within a

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period of ten consecutive assessment years, referred to in this section.

Explanation 3.--For the removal of doubts, it is hereby declared that the profits and gains derived from on site development of computer software (including services for development of software) outside India shall be deemed to be the profits and gains derived from the export of computer software outside India. Explanation 4.--For the purposes of this section, "manufacture or produce" shall include the cutting and polishing of precious and semi-precious stones."

8. As per sub-section (1), such profits and gains derived from export of articles, things or computer software are entitled to deduction. Sub-section (4) provides a method of computing the deduction and states that profits derived from export of articles, things or computer software shall be the amount of profit of the business of the undertaking in the same proportion as the export turnover (in respect of the articles, things or computer software) bears to the total turnover of business carried on by the undertaking. It incorporates a proportionate principle and has reference to three terms/expressions; ''export turnover'', ''total turnover'' and the ''profits of the undertaking''. Explanation 2 to the said provision defines the term ''export turnover''. On the basis of the figures, eligible profits derived from exports have to be computed.

9. The assessee accepts that the ''export turnover'' in the present case in terms of sub-section (3) to Section 10B of the Act, would not include Rs. 25,33,078/-, as the export proceeds were not brought into India in convertible foreign exchange, within the stipulated period. Thus, Rs. 25,33,078/- has to be reduced from ''export turnover''. It is also accepted that the total turnover would include Rs. 25,33,078/-. The resultant computation under Sub-Section (4) to Section 10B of the Act would reflect true and correct profits derived from the export turnover.

10. A simple example would be illustrative. An assessee, it can be assumed, has a total and export turnover of Rs. 1,00,000/- and net profit rate of 10%. On applying the formula as per Section 10B(4) of the Act, the profit eligible for deduction would be Rs. 10,000/- [(1,00,000/1,00,000) x 10,000]. However, in case the assessee has not received export proceeds of Rs. 10,000/-, the profit eligible for deduction under Section 10B(4) of the Act would be Rs. 9,000/- [(90,000/1,00,000) x 10,000]. However, in case we exclude unpaid export proceeds of Rs. 10,000/- from the net profit as declared, it would lead to an abnormal consequence of ''Nil'' profit and no deduction under Section 10B of the Act. This is not the purport of the formula stipulated in sub-Section (4) to Section 10B of the Act.

11. It is submitted that profits and gains of the business of the undertaking as declared, should not be interfered with, because of non-receipt of the export proceeds of Rs. 25,33,078/-. The reason is that the assessee was following mercantile system of accounts and therefore while computing the profits this amount cannot be excluded, though the payment was not actually received. The

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payments not received were not bad debt for the year in question, i.e. the year in which exports were made. It is further submitted that once the export turnover is reduced by Rs. 25,33,078/- as per the formula prescribed in sub-section (4), the result would be fair and equitable as the net profit eligible for deduction under Section 10B of the Act would get reduced proportionately. It is stated that it is for the assessee to claim bad debt and write it off under Section 36(1)(vii) of the Act. The assessee had treated the unrealized export proceeds of Rs. 25,33,078/- as bad debts in the assessment years 2007-08 and 2008-09, and the Assessing Officer or the Revenue is not competent to treat the aforesaid amount as bad debts in the year in question.

12. Reference in this regard can be made to the judgment of the Supreme Court in Vijaya Bank Vs. Commissioner of Income Tax and Another, , wherein it was held that the assessee is not only required to debit the Profit & Loss account but has to simultaneously reduce loans and advances or the debtors from the assets side of the balance sheet to the extent of the corresponding amount, so that at the end of the year the amount of the loans and advances or debtors is shown as the net of the provisions for the impugned bad debt. The Supreme Court in Vijaya Bank''s case (supra) referred to the following passage from Southern Technologies Ltd. Vs. Joint Commnr. of Income Tax, Coimbatore, ,

"Prior to April 1, 1989, the law, as it then stood, took the view that even in cases in which the assessee (s) makes only a provision in its accounts for bad debts and interest thereon and even though the amount is not actually written off by debiting the profit and loss account of the assessee and crediting the amount to the account of the debtor, the assessee was still entitled to deduction under section 36(1)(vii). (See Commissioner of Income Tax and Excess Profits Tax, Central, Bombay Vs. Jwala Prasad Tiwari, and Vithaldas H. Dhanjibhai Bardanwala Vs. Commissioner of Income Tax, Gujarat-V, . Such state of law prevailed up to and including the assessment year 1988-89. However, by insertion (with effect from April 1, 1989) of a new Explanation in section 36(1)(vii), it has been clarified that any bad debt written off as irrecoverable in the account of the assessee will not include any provision for bad and doubtful debt made in the accounts of the assessee. The said amendment indicates that before April 1, 1989, even a provision could be treated as a write off. However, after April 1, 1989, a distinct dichotomy is brought in by way of the said Explanation to section 36(1)(vii). Consequently, after April 1, 1989, a mere provision for bad debt would not be entitled to deduction under section 36(1)(vii). To understand the above dichotomy, one must understand ''how to write off''. If an assessee debits an amount of doubtful debt to the profit and loss account and credits the asset account like sundry debtor''s account, it would constitute a write off of an actual debt. However, if an assessee debits ''provision for doubtful debt'' to the profit and loss account and makes a corresponding credit to the ''current liabilities and provisions'' on the liabilities side of the balance-sheet, then it would constitute a provision for doubtful debt. In the latter case, the assessee would not be entitled to deduction after April 1, 1989."

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13. There is merit in the said submission, but it should not be understood that we have held that the Assessing Officer cannot go into or examine the quantum of net profit as declared. In a given case, he can hold that the net profit as declared has been increased or camouflaged to claim a higher deduction under Section 10B of the Act by reducing expenses or to gain tax arbitrage benefit in the current year. However, the said finding should be on cogent reasoning and incriminating facts. We add another caveat that our reasoning does not curtail or conclusively hold that in no case the authorities can examine the question of bad debt, etc. resulting in inflation of profits. The question if specifically raised, can be answered but in the facts of the present case, we do not find relevant discussion and factual basis to hold that the unpaid export proceeding of Rs. 25,33,078/- were bad debt for the year in question. We find that there is no discussion in the order passed by the Tribunal on the aforesaid aspects. Application and effect of Section 36(1)(vii) of the Act has not been examined and it has not been ascertained and verified whether the conditions mentioned in the said Section were satisfied in the assessment year in question, i.e. 2005-06. It has also not been ascertained whether unrealized export proceeds were treated as bad debt in the assessment years 2007-08 and 2008-09. The question of computation of deduction under Sub-Section (4) to Section 10B of the Act has also not been referred to and considered.

14. In view of the above, we answer the question of law partly in favour of the appellant assessee and against the Revenue but with an order of remand to the Tribunal to examine the aforesaid aspects.

The appeal is accordingly disposed of with no order as to costs.

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