

(1992) 01 GUJ CK 0021

In the Gujarat High Court

Case No : Income-tax Reference No. 178 of 1984

Testeels Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 13-01-1992

Acts Referred:

Income Tax Act, 1961 — Section 35B, 35B(1), 37

Citation : (1993) 110 CTR 320 : (1994) 205 ITR 230

Hon'ble Judges : R.C. Mankad, Acting C.J.; R.K. Abichandani, J

Bench : Division Bench

Advocate : H.M. Talati, for the Appellant; B.J. Shelat and M.R. Bhatt, for the Respondent

Judgement

R.C. Mankad, Actg.C.J.

1. The Tribunal has referred to us for our opinion the following question :

"Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that amounts mentioned below were not eligible for weighted deduction u/s 35B of the Income Tax Act, 1961 :

Rs. (a) Advertisement (local) 25,825 (b) 1/2 salary of Mr. T.S.K. Chari 25,000 (c) Bank guarantee charges 93,024 (d) Interest on export credits 10,98,881 (e) Membership fees (for institutions out of India) 48,867 (f) Interest-Central Bank 2,098 (g) Freight (up to destination out of India) 4,93,359 (h) Insurance (including insurance covered up to the point of destination) 2,34,539 (i) Packing material 49,945 (j) Tower testing charges 2,07,344 (k) Fabrication (monies spent out of India) 16,14,703 ----- 38,93,585 ?" -----

2. The assessee is a public limited company and the assessment year under reference is 1977-78, the year of account being the financial year ending on March 31, 1977. In the course of assessment for the said assessment year, the assessee claimed export markets development allowance or, in other words, weighted deduction u/s 35B of the Income Tax Act, 1961 ("the Act"), in respect

of the items of expenditure mentioned in the question and other items of expenditure with which we are not concerned in this reference. The Income Tax Officer, the Commissioner (Appeals) and the Tribunal disallowed the assessee's claim for weighted deduction in respect of the aforesaid expenditure. The Tribunal has, therefore, at the instance of the assessee, referred to us for our opinion, the question set out above.

3. Relevant portion of section 35B(1) reads as follows :

"35B. Export markets development allowance. - (1)(a) Where an assessee, being a domestic company or a person (other than a company) who is resident in India, has incurred after the 29th day of February, 1968, whether directly or in association with any other person, any expenditure (not being in the nature of capital expenditure or personal expenses of the assessee) referred to in clause (b), he shall, subject to the provisions of this section, be allowed a deduction of a sum equal to one and one-third times the amount of such expenditure incurred during the previous year :

Provided that in respect of the expenditure incurred after the 28th day of February, 1973, by a domestic company, being a company in which the public are substantially interested, the provisions of this clause shall have effect as if for the words "one and one-third times", the words "one and one-half times" had been substituted.

(b) The expenditure referred to in clause (a) is that incurred wholly and exclusively on -

(i) advertisement or publicity outside India in respect of the goods, services or facilities which the assessee deal in or provides in the course of his business;

(ii) obtaining information regarding markets outside India for such goods, services or facilities;

(iii) distribution, supply or provision outside India of such goods, services or facilities, not being expenditure incurred in India in connection therewith or expenditure (wherever incurred) on the carriage of such goods to their destination outside India or on the insurance of such goods while in transit;

(iv) maintenance outside India of a branch office or agency for the promotion of the sale outside India of such goods, services or facilities;

(v) preparation and submission of tenders for the supply or provision outside India of such goods, services or facilities, and activities incidental thereto;

(vi) furnishing to a person outside India samples or technical information for the promotion of the sale of such goods, services or facilities;

(vii) travelling outside India for the promotion of the sale outside India of such goods, services or facilities, including travelling outward from, and return to, India;

(viii) performance of services outside India in connection with, or incidental to, the execution of any contract for the supply outside India of such goods, services or facilities;

(ix) such other activities for the promotion of the sale outside India of such goods, services or facilities as may be prescribed."

4. It will be convenient to deal with each item of expenditure for which opinion is sought separately :

Advertisement (local). - The assessee had incurred expenditure of Rs. 25,825 for giving advertisement in Times of India on account of the visit of the President of Laos to India. Under sub-clause (i) of clause (b) of section 35B(1), the expenditure incurred for advertisement or publicity outside India qualifies for weighted deduction. Since the aforesaid expenditure was incurred for advertisement in India, it would not qualify for weighted deduction. Therefore, the Tribunal and the authorities below were right in not allowing the assessee's claim for weighted deduction in respect of the said expenditure.

5. 1/2 salary of Mr. T. S. K. Chari. - The assessee had paid salary of Rs. 50,000 to its employee, Mr. T. S. K. Chari, who was in charge of the export department. The assessee claimed weighted deduction in respect of the entire salary. The Income Tax Officer allowed the assessee's claim for weighted deduction only to the extent of 20 per cent. of the salary paid to Mr. T. S. K. Chari. In the appeal, however, the Commissioner, following the decision of the Tribunal in respect of the earlier year, directed the Income Tax Officer to allow weighted deduction in respect of half of the salary paid to Mr. T. S. K. Chari. The Tribunal, following its earlier decision, confirmed the view taken by the Commissioner.

6. It is not the case of the assessee that Mr. T. S. K. Chari was not looking after the business other than export. He may be exclusively in charge of the export department but that does not mean that he was not doing any work other than export. But even if he were exclusively dealing with export business and no other business of the assessee, the expenditure incurred for payment of his salary would qualify for weighted deduction only if it falls under one or more of the sub-clauses of clause (b) of section 35B(1). It is not stated as to what duties Mr. T. S. K. Chari was performing. It was having regard to the facts and circumstances of the case that the Tribunal attributed 50 per cent. of the expenditure incurred for payment of salary to Mr. T. S. K. Chari to the matters falling under the relevant sub-clause (b) of section 35B(1) and allowed weighted deduction in respect thereof. We do not see any reason to interfere with the view taken by the Tribunal. It may also be pointed out that, in the earlier year when the Tribunal allowed weighted deduction only in respect of 50 per cent. of the expenditure incurred for payment of salary to Mr. T. S. K. Chari, the assessee did not seek any reference. We, therefore, uphold the view taken by the Tribunal in regard to the expenditure incurred for payment of salary to Mr. T. S. K. Chari.

7. Bank guarantee charges. - The assessee had incurred expenditure of Rs.

93,024 by way of bank guarantee commission. It appears that the assessee's bank had given guarantee when tenders were submitted to parties outside India and, for that purpose, it had charged commission of Rs. 93,024. The assessee's contention was that since the expenditure was incurred for export development, it was entitled to claim weighted deduction in respect thereof. There is no sub-clause in clause (b) of section 35B(1) which covers expenditure incurred for export development as claimed by the assessee. In our opinion, the expenditure which the assessee had incurred was in connection with the supply of goods outside India and such expenditure would fall under sub-clause (iii) of clause (b) of section 35B(1). However, the assessee would not be entitled to claim weighted deduction in respect of the said expenditure inasmuch as the expenditure is incurred in India. The expenditure incurred in India in connection with supply of goods outside India does not qualify for weighted deduction under the said sub-clause (iii). The Tribunal was, therefore, right in rejecting the assessee's claim for weighted deduction in respect of the said expenditure.

8. Interest on export credits. - The assessee had incurred expenditure of Rs. 10,98,881 in paying interest to its bank on the advances and loans given for purchase of raw materials. This facility of advance or loan given by the bank is described as "banking credit facility". The assessee claimed weighted deduction in respect of the said expenditure. The Income Tax Officer, the Commissioner and the Tribunal have rejected the assessee's claim. The Tribunal rejected the claim of the assessee, relying on a decision of its Special Bench in the case of J. Hemchand and Co. v. Second ITO [1982] 1 SOT 150 (Bom).

9. It is contended on behalf of the assessee that the aforesaid expenditure in respect of which the assessee had claimed weighted deduction would fall under sub-clause (viii) of clause (b) of section 35B(1) and, therefore, the assessee is entitled to weighted deduction in respect of the said expenditure. It is submitted that the assessee had performed services outside India by supplying goods to foreign buyers and it was for rendering such services that it had to purchase raw materials. It is the case of the assessee that, from the credit, advances or loans given by the bank, it purchased raw materials to manufacture the products or goods which were exported and it had to pay interest to the bank for such credit advances or loans. Therefore, according to the assessee, the expenditure in paying interest to the bank was incurred in performance of services outside India and such expenditure, which falls under sub-clause (viii) of clause (b), qualifies for weighted deduction. In support of this contention, strong reliance was placed by the assessee on the decision of the Madhya Pradesh High Court in the case of Commissioner of Income Tax Vs. Vippy Solvex Product Private Limited, , and the decision of the Andhra Pradesh High Court in the case of Commissioner of Income Tax Vs. Navabharat Enterprises (P.) Ltd., .

10. The assessee is entitled to weighted deduction as provided in clause (a) of section 35B in respect of expenditure referred to in clause (b). Therefore, in order to qualify for weighted deduction, the expenditure must be of one of the

kinds enumerated in clause (b). If the expenditure falls under any of the sub-clauses of clause (b), the assessee who has incurred such expenditure would be entitled to weighted deduction under clause (a). The assessee has claimed weighted deduction in respect of the expenditure incurred for payment of interest on packing credit facility account under sub-clause (viii) of clause (b). In order that an expenditure may fall under sub-clause (viii), the assessee has to establish that the expenditure was incurred in the performance of services outside India in connection with, or incidental to, the execution of any contract for the supply outside India such goods, services or facilities. It is clear that, in order to fall under sub-clause (viii), the expenditure has to be incurred for performance of services outside India and such performance of services outside India has to be in connection with, or incidental to, the execution of any contract for the supply outside India of goods, services or facilities. But, so far as sub-clause (viii) is concerned, as pointed out above, it deals with expenditure which is incurred in performance of services outside India. However, performance of services outside India has to be in connection with or incidental to the execution of any contract for the supply outside India of such goods, services or facilities. As pointed out above, provisions for weighted deduction is made to give incentive to export. If no services are performed outside India in connection with or incidental to the execution of any contract for the supply outside India of goods, services or facilities, the expenditure incurred for performance of services would not be covered by sub-clause (viii). In the instant case, the assessee is given facility of credit or loan for buying raw materials for the manufacture of goods which were exported. Firstly, no services are performed in taking credit or loan facility from the bank in order to purchase raw materials for manufacture of goods. Secondly, even if any services were performed, such services are not performed outside India. We fail to see what services are rendered when the assessee taken advantage of credit or loan facility from the bank and pays interest to it. It is the business of the assessee to manufacture goods and sell or export the goods which are manufactured. The activity of export of goods outside India by itself would not be services contemplated by sub-clause (viii). What is contemplated by sub-clause (viii) is performance of services outside India in connection with or incidental to the execution of any contract for the supply outside India of such goods, service or facilities. What the assessee has done is to enter into a contract with a foreign buyer for supply of good outside India. That is part of the business of the assessee and supply of goods to the foreign buyer by exporting them outside India would not amount to rendering of any services. Services performance of which is contemplated by sub-clause (viii) have to be rendered outside India. Purchase of raw materials from the credit or loan facility given by the bank to the assessee was part of the business of the assessee and it was from these raw materials that it manufactured goods which it exported in execution of the contract. In our opinion, the assessee has not rendered or performed any services outside India as contemplated by sub-clause (viii) and, therefore, interest paid by it to the bank on the credit or loan facility given to it would not be covered by sub-clause (viii) and it would not, therefore,

be eligible for weighted deduction.

11. In Commissioner of Income Tax Vs. Vippy Solvex Product Private Limited, , on which strong reliance was placed on behalf of the assessee, the facts were as follows :

12. The assessee which manufactured and exported deoiled cakes claimed that a sum of Rs. 4,72,960 incurred by it as expenditure was eligible for weighted deduction u/s 35B. The break-up of the expenditure was as follows :

(1) Interest paid to bank on export packing credit account (Rs. 3,65,875).

(2) Commission and brokerage for export (Rs. 81,500).

(3) Postage, telephone and telegram expenses (Rs. 8,460).

(4) Bank commission on export packing credit account (Rs. 17,125).

13. The Income Tax Officer allowed the claim of the assessee to the extent of one-third of the expenditure, namely, Rs. 1,57,653. The Commissioner found that the order of the Income Tax Officer was erroneous and prejudicial to the interests of the Revenue, and, hence, directed the Income Tax Officer to withdraw the allowance. So far as we are concerned, the only question which is relevant is whether the assessee was entitled to weighted deduction in respect of the interest paid to the bank on export packing credit account. In the appeal before it, the Tribunal found that the assessee had maintained with the Bank of Maharashtra an export packing credit account and advances from this account were given only for the purchase of raw materials for manufacturing goods to be exported outside India. The assessee had paid interest of Rs. 3,65,875 in this account to the Bank of Maharashtra. On these facts, the Tribunal held that the expenditure which the assessee had incurred in paying interest was incurred in the performance of services outside India or they were incidental to, or they were incurred in the execution of, the contract for supply outside India of such goods, services and facilities and assessee was entitled to weighted deduction of these expenses u/s 35B(1)(b)(viii). On a reference, the Division Bench of the Madhya Pradesh High Court held as follows (at page 493) :

"This section provides a deduction of a sum equal to one-third of the amount of such expenditure incurred during the previous year, and sub-clause (viii) of sub-section (1)(b) of this section provides that such expenditure, if it is incurred for the purposes indicated in the sub-clause, the assessee will be entitled to the advantage of this section. Sub-clause (viii) talks of performance of services outside India in connection with, or incidental to, the execution of any contract for the supply outside India of such goods, services or facilities. This, therefore, contemplates that expenditure incurred in connection with the services rendered outside India or expenditure incurred in connection with or incidental to the execution of any contract for the supply outside India of such goods will be covered under this section. The findings of fact arrived at by the Tribunal on the basis of the certificate issued by the bank clearly show that all these credits in

this account were given for purchase of raw material and this credit is only given when the contract for supply of goods to the foreign parties is shown and, therefore, these findings of fact clearly indicate that this expenditure was incurred in connection with the execution of any contract for supply outside India. It is significant that even incidental expenditure will be covered under this clause as the language shows if the expenditure is in connection with or incidental to the execution of the contract. In this view of the matter, therefore, on the findings of fact arrived at by the learned Tribunal, it appears that the view taken by the Tribunal is correct."

14. With respect, we are unable to agree with the view taken by the Division Bench of the Madhya Pradesh High Court. It is not correct to say that sub-clause (viii) contemplates that expenditure incurred in connection with the services rendered outside India or expenditure incurred in connection with or incidental to the execution of any contract for supply outside India of such goods will be covered under this section. In our opinion, the correct position is that sub-clause (viii) contemplates that expenditure incurred in connection with performance of services rendered outside India in connection with or incidental to the execution of any contract for supply outside India of goods, services or facilities would be covered by sub-clause (viii). If the view taken by the Division Bench of the Madhya Pradesh High Court that expenditure incurred in connection with or incidental to the execution of any contract for supply outside India of goods, services or facilities would be covered by sub-clause (viii) is correct, then the remaining sub-clause would be rendered nugatory.

15. In Commissioner of Income Tax Vs. Navabharat Enterprises (P.) Ltd., , facts before the Division Bench of the Andhra Pradesh High Court were as follows :

16. The assessee claimed weighted deduction in respect of Rs. 2,05,211 paid to the Export Credit Guarantee Corporation for information furnished to the assessee regarding credit-worthiness of the foreign purchasers and also for providing a guarantee for payment of amounts by such foreign purchasers. The Income Tax Officer rejected the claim but the appellate authorities allowed it. On reference, the Division Bench of the Andhra Pradesh High Court held that section 35B of the Act, bearing the caption "Export markets development allowance" is designed to provide more deduction than the deduction normally allowed u/s 37 with a view to giving an impetus to exports. Sub-clause (ii) of section 35B(1)(b) contemplates deduction of expenditure incurred for obtaining information regarding markets outside India. This is obviously aimed at giving relief in respect of amounts spent for the survey of export potential. Sub-clause (viii) of section 35B(1)(b), according to the Division Bench of the Andhra Pradesh High Court, envisages deduction for performance of services relating to execution of contracts for the supply of goods outside India. It was held that it was not necessary that the person or corporation rendering services should be situated outside India and it was sufficient to attract sub-clause (viii) that services are rendered outside India even if the person or corporation performing such

services is situated in India. It was, therefore, held that the expenditure claimed by the assessee comprised payments made for obtaining information regarding the market ability of goods and to the Export Credit Guarantee Corporation for being apprised of the credit-worthiness of the foreign buyer and for providing guarantee for the payment. The expenditure incurred by the assessee for obtaining information regarding market potentiality for goods sought to be put in the stream of exports was squarely within the purview of sub-clause (ii) of section 35B(1)(b). The payment made to the Export Credit Guarantee Corporation to ensure the financial capacity of the foreign buyer to fulfil the commitment of deferred payment and insulate the assessee against the risk of non-recovery from the foreign buyer was covered by sub-clause (viii) of section 35B(1)(b). The assessee was, therefore, entitled to claim weighted deduction u/s 35B in respect of the expenditure of Rs. 2,05,211. We fail to see how this decision of the Andhra Pradesh High Court can be of any assistance to the assessee. In this reference, we are not concerned with the assessee's claim for weighted deduction in respect of expenditure covered by sub-clause (ii) of section 35B(1)(b). So far as the assessee's claim in respect of the expenditure incurred for payment made to the Export Credit Guarantee Corporation to ensure the financial capacity of the foreign buyer is concerned, according to the Division Bench of the Andhra Pradesh High Court, such expenditure would be covered by sub-clause (viii) of section 35B(1)(b). Assuming that such expenditure would fall under sub-clause (viii), as held by the Andhra Pradesh High Court, it would not help the assessee in the instant case. It appears from the judgment of the Division Bench of the Andhra Pradesh High Court that the Export Credit Guarantee Corporation had in fact rendered services outside India to find out the credit-worthiness of the foreign purchasers and for providing a guarantee for payment of amounts by such foreign purchasers. So far as services rendered by the Export Credit Guarantee Corporation for collecting information regarding the credit-worthiness of the foreign purchasers are concerned, they would fall under sub-clause (viii) of section 35B(1)(b). In the instant case, no services, whatsoever, have been performed outside India.

17. In the light of the above discussion, we are of the opinion that the assessee is not entitled to weighted deduction u/s 35B in respect of the expenditure of Rs. 10,98,881 incurred by it for paying interest on the credit advances or loans given by the bank, as aforesaid. Similar view was taken by us in *Commissioner of Income Tax Vs. Jay Industries*, (income tax Reference No. 337 of 1984, dated January 8, 1992).

18. Membership fees (for institutions out of India). - The assessee incurred an expenditure of Rs. 48,867 in becoming member of institutions outside India. It claimed weighted deduction in respect of such expenditure. The Income Tax Officer disallowed the assessee's claim. The appellate authorities, namely, the Commissioner and the Tribunal, confirmed the disallowance.

19. We are not inclined to take a view different from the view taken by the

Tribunal. No details are furnished regarding the expenditure incurred by the assessee for payment of fees for becoming member of institutions outside India. It is also not stated as to what was the purpose or object of becoming a member of the institutions outside India. It is also not stated as to which of the sub-clauses of section 35B(1)(b) would cover the expenditure in question. Under the circumstances, we see no reason to disturb the finding of the Tribunal and take a view different from the view taken by it.

20. Interest paid to Central Bank. - The assessee paid interest of Rs. 2,098 to the Central Bank. Details of this payment of interest were also not explained to us. But, apart from that, such expenditure for payment of interest was directly covered by our decision in *Isabgul Export Corporation v. CIT* [1994] 205 ITR 227 (income tax Reference No. 94 of 1982, decided on December 5, 1991). Following the said decision, the assessee's claim cannot be allowed.

21. Freight and insurance. - The assessee had incurred expenditure of Rs. 4,93,359 for freight and Rs. 2,34,539 for insurance for exporting goods outside India. It is clear that if both the said items of expenditure were incurred for supply of goods outside India, then they would be covered by sub-clause (iii) of section 35B(1)(b). Sub-clause (iii) clearly lays down that expenditure incurred for freight and insurance is not admissible for weighted deduction. The assessee's claim in respect of the said expenditure, therefore, cannot be allowed.

22. Packing material. - The assessee had incurred expenditure of Rs. 49,945 for packing and claimed weighted deduction in respect thereof u/s 35B. This claim is directly covered by our decision in *Isabgul Export Corporation v. CIT* [1994] 205 ITR 227 (income tax Reference No. 94 of 1982, decided on December 5, 1991). Following the said decision, we confirm the view taken by the Tribunal and disallow the assessee's claim.

23. Tower testing charges. - The assessee had incurred expenditure of Rs. 2,07,344 for testing towers. This expenditure was also incurred in connection with the supply of goods outside India, which would be covered by sub-clause (iii). It is not disputed that this expenditure was incurred in India. Therefore, weighted deduction in respect of the said expenditure cannot be allowed, as clearly provided in sub-clause (iii).

24. Fabrication. - It appears that the assessee had incurred expenditure for fabrication of towers in Nepal Laos. The assessee had exported goods to customers of Nepal and Laos and, therefore, it had to incur expenditure, as aforesaid, for fabrication of towers. This expenditure admittedly is incurred outside India. It appears that the assessee had undertaken the work of fabrication of towers under contracts with the foreign buyers. The Income Tax Officer, however, disallowed the assessee's claim on the ground that such expenditure was not covered by any of the sub-clauses of section 35B(1)(b). The view taken by the Income Tax Officer was confirmed by the Commissioner and the Tribunal.

25. The work of fabrication which the assessee had carried out was directly connected with and incidental to its contract with foreign buyers to supply goods. In other words, it is an expenditure which is connected with the supply of goods outside India. As already pointed out above, it is not an expenditure incurred in India. In our opinion, therefore, the above expenditure would be directly covered by sub-clause (iii) of section 35B(1)(b). In other words, the assessee would be entitled to weighted deduction in respect of the said expenditure of Rs. 16,14,703 u/s 35B(1)(a). We, therefore, cannot uphold the view of the Tribunal in that regard.

26. The result, therefore, is that we uphold the view taken by the Tribunal except in regard to the expenditure incurred for fabrication of towers. As held above, so far as the expenditure of Rs. 16,14,703 incurred for fabrication of towers in Nepal and Laos is concerned, the assessee is entitled to weighted deduction u/s 35B. We, therefore, answer the question which has been referred to us in the affirmative and against the assessee in respect of all the items of expenditure mentioned in the question except the last item regarding fabrication of towers. So far as expenditure of Rs. 16,14,703 incurred for fabrication of towers in Nepal and Laos is concerned, the question referred to us for our opinion, is answered in the negative and against the Revenue. Reference answered, accordingly, with no order as to costs.