

Bombay High Court The Commissioner Of Income Tax-24 vs M/S. Shah Originals on 22 April, 2010 Bench: Dr. D.Y. Chandrachud, J.P. Devadhar 1

IN THE HIGH COURT OF JUDICATURE AT BOMBAY

O. O. C. J.

INCOME TAX APPEAL NO.431 OF 2008

The Commissioner of Income Tax-24
C-11, Pratyakshakar Bhavan,

Bandra-Kurla Complex, Bandra (E),
Mumbai 400 051.

..Appellant.

Vs.

M/s. Shah Originals,
115, High Tech Industrial Centre,
Caves Road, Jogeshwari (East),
Mumbai 400 060.

..Respondent.

.....

Ms. Suchitra Kamble for the Appellant.
Mr. Vipul B. Joshi with Mr. Sameer G. Dalal for the Respondent.

....

CORAM : DR. D.Y.CHANDRACHUD &
J.P. DEVADHAR, JJ.

22 April, 2010. ORAL JUDGMENT (Per DR. D.Y. CHANDRACHUD, J.): 1. The Appeal filed by the Revenue under Section 260-A of the Income Tax Act, 1961 has been admitted on the following question of law : “(a) Whether on the facts and in circumstances of the case, and in law, the Hon’ble Tribunal was right in holding that the receipts on account of Foreign Exchange Fluctuation on EEFC Account and interest on EEFC Account can be treated as part of business income and accordingly included in the profit of business while calculating deduction u/s 80HHC?” 2. The Appeal arises out of proceedings for Assessment Year 2000-01. The order of the Income Tax Appellate Tribunal dated 25 October 2007 is a common order which governs Assessment Years 2000-01, 2001-02, 2002-03, 2003-04 and 2004-05. The assessee filed a return of income for Assessment Year 2000-01 declaring a total income of Rs.28,25,080/-. An order of assessment was passed under Section 143(3) on 25 March 2003 accepting the income as returned. The assessee had claimed a deduction under Section 80-HHC in the amount of Rs.4.16 Crores on the basis that the export turnover amounted to Rs.8.27 Crores. According to the Revenue, during the previous year, the actual export turnover was Rs.8 Crores, the differential amount of Rs.26.62 lacs being on account of gains arising out of foreign currency fluctuation. The assessment came to be reopened upon a notice under Section 148, the contention of the Revenue being that the gains on account of foreign currency fluctuation had no relationship with the exports made during the year and that these receipts were accordingly liable to be excluded from the export turnover for computing the deduction under Section 80- HHC. 3. The assessee, it is common ground before the Court, had opened an Exchange Earners Foreign Currency (EEFC) Account in the earlier year. According to the assessee the balance-sheet reflected the conversion of the balance at the end of the year into Indian rupees at the prevailing exchange rate. The fluctuation on account of foreign exchange rates was predicated to the foreign exchange account. 4. The Assessing Officer found that the Reserve Bank of India allows exporters to keep a specified percentage of receipts on account of export in the EEFC Account. The option lies with the exporter to decide whether the total amount of the export proceeds should be received in rupee equivalent or whether a certain percentage should be kept in the EEFC Account in accordance with the prescriptions of the Reserve Bank. The Assessing Officer noted that the assessee had realized the full amount on account of export. If the amount was kept in a rupee account, there would be no receipt on account of foreign exchange fluctuation. The fluctuation was as a result of the assessee keeping a portion of the receipts of export in the EEFC Account. The Assessing Officer noted that this was not a case where there was a delayed realization of export proceeds consequent upon which an exchange

fluctuation arose. Consequently, the entire receipt of Rs.26.62 lacs on account of exchange fluctuation was treated as income under the head of income from other sources. The assessee also received interest income of Rs.31.29 lacs from the EEFC Account. This receipt was also treated as income under the head of income from other sources. 5. The order of the Assessing Officer was affirmed on these two aspects by the Commissioner of Income Tax (Appeals). The Commissioner of Income Tax (Appeals) also observed that the export transaction stood concluded upon the receipt of the entire export proceeds. The subsequent user of the sale proceeds by maintaining an EEFC Account would not alter the situation and this was distinct and independent from the transaction of export which already stood concluded. The Commissioner noted that the gains on account of exchange fluctuation arose subsequent to the transaction of export and it had no relationship with the export activity. Consequently, the gain was regarded as not amounting to business income. The Commissioner of Income Tax (Appeals) also noted that under Section 80-HHC profits arising out of the export of goods could be claimed as a deduction. Hence, the income which arose on the subsequent user of the export proceeds would be altogether of a different nature and could not be said as derived from export activity. The Commissioner of Income Tax (Appeals) also clarified that this was not a case where the exchange fluctuation occurred as a result of a delayed realization of the export proceeds. Similarly, the interest which was received on the deposit in the EEFC Account was also classified as income from other sources. 6. The Tribunal has reversed the findings of the Commissioner of Income Tax (Appeals) by its impugned order. The Tribunal has simply relied upon its own judgments in certain other cases and following the view of its co-ordinate benches the appeal filed by the assessee was allowed. 7. Counsel appearing on behalf of the Revenue submits that the transactions pertaining to export stand concluded and the entire quantum of export proceeds was received. Subsequent to the conclusion of the export transaction, the assessee chose to maintain a certain proportion of the proceeds in the form of a convertible foreign exchange, EEFC Account. The exchange fluctuation which arises out of the deposits held in the EEFC Account cannot, it was urged, be regarded as being derived from the export business for the purposes of Section 80-HHC. Learned counsel supported the reasoning contained in the order of the Commissioner of Income Tax (Appeals) and submitted that the Tribunal had not evaluated either the provisions of the statute or the circumstances of the case which would lead to a rejection of the claim for deduction. 8. On the other hand, counsel appearing on behalf of the assessee submitted that (i) The ambit of the expression 'business' includes not only buying and selling for the purposes of export, but all ancillary activities; (ii) The intention of the assessee in keeping a portion of the sale proceeds of export in the EEFC Account was not to gain from a foreign exchange fluctuation but, to facilitate the meeting of future business liabilities and (iii) The deposits held in the EEFC Account had arisen purely as a result of the export profits. 9. In evaluating the rival submissions, due regard must be had to the intendment of Parliament as evidenced by the language used in sub section (1) of Section 80-HHC. The statute contemplates a deduction where an assessee, being an Indian company

or a person resident in India, is engaged in the business of export out of India of any goods or merchandise to which the Section applies. In such a case, the assessee is allowed, in computing the total income a deduction to the extent of profits derived by the assessee from the export of goods or merchandise. The deduction in other words, relates to the profits that are derived by the assessee from export. Sub section (2)(a) postulates that the Section applies to all goods or merchandise where the sale proceeds of the export 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. 10. The resolution of the issues which fall for determination in this appeal must essentially turn on whether the receipts in question on account of exchange fluctuation and of interest earned on deposits held in the EEFC Account can be regarded as being derived from the export of goods or merchandise. Now it is a well settled principle of law that the expression 'derived' is of a narrower connotation than the expression 'attributable to'. The expression 'derived' postulates the existence of a direct and proximate nexus with the export activity. The expression 'derived from' was explained in the judgment of the Supreme Court in *Pandian Chemicals Limited v. Commissioner of Income Tax*¹ in the context of the use of that expression in Section 80-HH. In that case the assessee had placed a deposit with an electricity board for obtaining the supply of electricity and the submission of the assessee was that the undertaking itself could not run in the absence of electricity. Consequently, it was urged that the interest received on the deposits placed with the electricity board must be regarded as being derived from the industrial undertaking. The Supreme Court rejected this submission, holding that the expression derived from "must be understood as something which has direct or immediate nexus". The Court held that though electricity may be required for the industrial undertaking, the deposit required for such supply "is a step removed from the business" and the derivation of profits on the deposit made "cannot be said to flow directly from the industrial undertaking itself" 1 (2003) 129 Taxman 539 (SC). (at paragraph 6). The same principle has been reiterated by the Supreme Court in *Commissioner of Income Tax v. K. Ravindranathan Nair*² specifically in the context of the provisions of Section 80-HHC. 11. The assessee admittedly in the present case received the entire proceeds of the export transaction. The Reserve Bank of India, has granted a facility to certain categories of exporters to maintain a certain proportion of the export proceeds in an EEFC Account. The proceeds of the account are to be utilized for bonafide payments by the account holder subject to the limits and the conditions prescribed. An assessee who is an exporter is not under an obligation of law to maintain the export proceeds in the EEFC Account but, this is a facility which is made available by the Reserve Bank. The transaction of export is complete in all respects upon the repatriation of the proceeds. It lies within the discretion of the exporter as to whether the export proceeds should be received in a rupee equivalent in the entirety or whether a portion should be maintained in convertible 2 (2007) 295 ITR 228. foreign exchange in the EEFC Account. The exchange fluctuation that arises, it must be emphasized, is

after the export transaction is complete and payment has been received by the exporter. Upon the completion of the export transaction, what the seller does with the proceeds, upon repatriation, is a matter of his option. The exchange fluctuation in the EEFC Account arises after the completion of the export activity and does not bear a proximate and direct nexus with the export transaction so as to fall within the expression “derived” by the assessee in sub section (1) of Section 80-HHC. Both the Assessing Officer and the Commissioner of Income Tax (Appeals) have made a distinction, which merits emphasis. The exchange fluctuation, as both those authorities noted, arose subsequent to the transaction of export. In other words, the exchange fluctuation was not on account of a delayed realization of export proceeds. The deposit of the receipts in the EEFC Account and the exchange fluctuation which has arisen therefrom cannot be regarded as being part of the profits derived by the assessee from the export of goods or merchandise. 12. The interest which has arisen as a result of the deposits maintained in the EEFC Account can similarly not be regarded as representing the business income of the assessee. The business of the assessee consists of the manufacture and export of garments. The interest income which was generated from the deposits held in the EEFC Account would not fall for classification as income under the head of business and profession but, would fall for classification as income from other sources. Undoubtedly as counsel appearing on behalf of the assessee submits, in determining under which head, income would fall, the Court must be guided by the principle laid down by the Supreme Court in *Nalinikant Ambalal Mody v. S.A.L. Narayan Rao*, CIT 3 The Supreme Court held that “whether an income falls under one head or another has to be decided according to the common notions of practical men, for the Act does not provide any guidance in the matter”. The interest which accrued to the assessee on the deposits held in the EEFC Account cannot be treated as business income. 3 (1966) 61 ITR 428 (SC). 13. The Tribunal has merely relied upon decisions of its co- ordinate benches and there is merit in the submission of counsel appearing on behalf of the Revenue that the Tribunal ignored the plain meaning and intendment of the words used by Parliament while legislating upon Section 80-HHC. The fluctuation in the present case is not on account of the sale proceeds or for that matter on account of a delayed realization of the sale proceeds. The fluctuation has arisen in the deposits maintained by the assessee in the EEFC Account in convertible foreign exchange after the completion of the export transaction. 14. For these reasons, we are of the view that the appeal would have to be allowed and that the question of law as formulated would have to be answered in favour of the Revenue and against the assessee. There shall be an order in these terms. In the circumstances of the case, there shall be no order as to costs. (Dr. D.Y.Chandrachud, J.) (J.P. Devadhar, J.)