Bombay High Court The Commissioner Of Income Tax-8 vs M/S. Gem Plus Jewellery India Ltd on 23 June, 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.2426 OF 2009

The Commissioner of Income Tax-8 ..Appellant.
Vs.

M/s. Gem Plus Jewellery India Ltd. ..Respondent.

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Ms Suchitra Kamble for the Appellant.

Ms Arti Vissanji with Mr. S.J. Mehta for the Respondent.

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

23 June 2010. ORAL JUDGMENT (Per. DR.D.Y.CHANDRACHUD, J.) : 1. Admit. On the request of counsel for the Revenue and counsel for the assessee, the appeal is taken up for final hearing. 2. This appeal by the Revenue under Section 260-A of the Income Tax Act, 1961 pertains to Assessment Year 2003-04 and the following questions of law have been formulated in support of

the appeal : “a. Whether on the facts and in the circumstances of the case, the Tribunal was justified in holding that the exemption u/s.10A of the Act should be computed after excluding freight and insurance from the total turnover; b. Whether on the facts and in the circumstances of the case, the Tribunal was justified in directing the Assessing Officer to grant the exemption u/s.10A of the Act on the assessed income, which was enhanced due to disallowance of employer's as well as employee's contribution towards PF / ESIC; c. Whether on the facts and in the circumstances of the case, the Tribunal was justified in upholding the stand of the CIT(A) in treating the interest income as business income and interest income should be taken for the purpose of deduction claimed u/s. 80HHC of the I.T. Act, 1961; d. Whether on the facts and in the circumstances of the case, the Tribunal was justified in upholding the stand of the CIT(A) considering the net interest and not gross interest for the purposes of exclusion under clause (baa) of Explanation to Section 80HHC of the I.T. Act, 1961; e. Whether on the facts and in the circumstances of the case, the Tribunal was justified in directing the Assessing Officer to grant exemption u/s. 10A on foreign exchange gain earned on realization of export receipts in the year of export and to exclude the gains on sales of earlier years from the profits of the year under consideration and allow in those years;” Re Question a : 3. According to the Revenue the exemption under Section 10A is liable to be computed after excluding freight and insurance from the total turnover. The Commissioner (Appeals) affirmed the view of the Assessing Officer and held that Section 10A does not define turnover and that in the circumstances, the Assessing Officer was correct in not reducing insurance and freight from the total turnover while computing the deduction under Section 10A. In appeal the Tribunal held that (i) The expression “total turnover” has not been defined in Section 10A; (ii) Profits derived from export have to be computed by taking into consideration both the export turnover and total turnover of the business carried on by the undertaking; (iii) Both the export turnover and total turnover which constitute the numerator and denominator in the application of the formula under sub section (4) of Section 10A should be comparable; and (iv) Freight and insurance have no element of profit and hence, cannot be included in the total turnover of the business carried on by the industrial undertaking. The Tribunal accordingly directed that the deduction under Section 10A should be computed after excluding freight and insurance from the total turnover. It is this finding of the Tribunal which is questioned by the Revenue in appeal. 4. Under sub section (1) of Section 10A a deduction is allowed from the total income of the assessee of such profits and gains as are derived by an undertaking from the export of articles or things or computer software for a period of ten consecutive assessment years commencing from the assessment year relevant to the previous year in which the undertaking begins manufacture or production. Sub section (4) of Section 10A provides the manner in which the profits derived from the export of articles or things or computer software shall be computed. Sub section (4) provides as follows : “For the purposes of sub sections (1) and (1A), 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." 5. Under sub section (4) the proportion between the export turnover in respect of the articles or things, or as the case may be, computer software exported, to the total turnover of the business carried over by the undertaking is applied to the profits of the business of the undertaking in computing the profits derived from export. In other words, the profits of the business of the undertaking are multiplied by the export turnover in respect of the articles, things or, as the case may be, computer software and divided by the total turnover of the business carried on by the undertaking. The formula which is prescribed by sub section (4) of Section 10A is as follows : Profits derived from export of articles or things or computer software = Profits of the business export turnover in respect of the undertaking X of the articles or things or computer software

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divided by total turnover of the business carried on by the undertaking. The total turnover of the business carried on by the undertaking would consist of the turnover from export and the turnover from local sales. The export turnover constitutes the numerator in the formula prescribed by sub section (4). Export turnover also forms a constituent element of the denominator inasmuch as the export turnover is a part of the total turnover. 6. The export turnover, in the numerator must have the same meaning as the export turnover which is a constituent element of the total turnover in the denominator. The legislature has provided a definition of the expression "export turnover" in Explanation (2) to Section 10A by which the expression is defined to mean the consideration in respect of export by the undertaking of articles, things or computer software received in or brought into India by the assessee in convertible foreign exchange but so as not to include inter alia freight, telecommunication charges or insurance attributable to the delivery of the articles, things or software outside India. Therefore in computing the export turnover the legislature has made a specific exclusion of freight and insurance charges. 7. The submission which has been urged on behalf of the Revenue is that while freight and insurance charges are liable to be excluded in computing export turnover, a similar exclusion has not been provided in regard to total turnover. The submission of the Revenue, however, misses the point that the expression "total turnover" has not been defined at all by Parliament for the purposes of Section 10A. However, the expression "export turnover" has been defined. The definition of "export turnover" excludes freight and insurance. Since export turnover has been defined by Parliament and there is a specific exclusion of freight and insurance, the expression "export turnover" cannot have a different meaning when it forms a constituent part of the total turnover for the purposes of the application of the formula. Undoubtedly, it was open to Parliament to make a provision to the contrary. However, no such provision having been made, the principle which has been enunciated earlier must prevail as a matter of correct statutory interpretation. Any other interpretation would lead to an absurdity. If the contention of the Revenue were to be accepted, the same expression viz.

'export turnover' would have a different connotation in the application of the same formula. The submission of the Revenue would lead to a situation where freight and insurance, though it has been specifically excluded from "export turnover" for the purposes of the numerator would be brought in as part of the "export turnover" when it forms an element of the total turnover as a denominator in the formula. A construction of a statutory provision which would lead to an absurdity must be avoided. 8. The view which we have taken is consistent with the view which was taken, though in the context of Section 80HHC, by a Division Bench of this Court in Commissioner of Income Tax v. Sudarshan Chemicals Industries Ltd.1 In Sudarshan Chemicals the question of law that fell for decision was whether sales tax and excise duty ought to be included in the total turnover while working out the deduction under Section 80HHC. For the purposes of Section 80HHC, clause (b) of sub section (3) provides that the profits derived from export shall be computed in terms of the proportion between the export turnover to the total turnover 1 (2000) 245 ITR 769. as applied to the profits of business. Hon'ble Mr. Justice S.H. Kapadia (as the Learned Chief Justice then was) speaking for a Division Bench of this Court did not accept the contention of the Revenue that since the legislature had excluded only insurance and freight from the total turnover, it was not open to the assessee to contend that excise duty and sales tax should also be excluded. In that context, the Division Bench observed that the meaning of export turnover in clause (b) of the Explanation to Section 80HHC showed that export turnover did not include excise duty and sales tax. The Division Bench observed that the export turnover is the numerator in the formula whereas the total turnover is the denominator. The formula having been prescribed to arrive at profits from exports, sales tax and excise duty could not form part of the total turnover. If the denominator were to include those two items and the numerator excluded them, the formula (noted the Division Bench), would become unworkable. In the circumstances, the Division Bench held that while ascertaining the export profits, excise duty and sales tax could not be introduced to inflate the total turnover artificially in order to reduce the benefit to which the assessee is entitled. The decision of the Division Bench of this Court in Sudarshan Chemical Industries has been cited with approval by the Supreme Court in Commissioner of Income Tax v. Lakshmi Machine Works2. The same view has been taken by the Supreme Court in Commissioner of Income Tax v. Catapharma (India) Pvt. Ltd.3 in which the decision of the Division Bench in Sudarshan Chemical Industries has also been adverted to. 9. Moreover, a receipt such as freight and insurance which does not have any element of profit cannot be included in the total turnover. In Lakshmi Machine Works (supra) the Supreme Court held that excise duty and sales tax did not possess any element of turnover since they are merely recoverable by the assessee on behalf of the Government. 10. Freight and insurance do not have an element of turnover. For this reason in addition, these two items would have to be 2 (2007) 290 ITR 667 (SC). 3 (2007) 292 ITR 641 (SC). excluded from the total turnover particularly in the absence of a legislative prescription to the contrary. The first question of law would therefore have to be answered

against the Revenue and in favour of the assessee. Re Question b : 11. For the purposes of the appeal it is necessary to refer to the admitted position which is that the assessee had deposited both the employer's and the employees' contribution towards Provident Fund and ESIC, though beyond the due date including the grace period. The Assessing Officer added these payments to the total income of the assessee and made an addition in the amount of Rs. 71.59 lacs. However, for the deduction under Section 10A, the addition made on account of the employees' contribution was ignored in calculating the profits eligible for deduction on the ground that these receipts were not generated out of the manufacturing activity of the assessee company. 12. By reason of the judgment of the Supreme Court in Commissioner of Income Tax v. Alom Extrusions Limited4 the employer's contribution was liable to be allowed, since it was deposited by the due date for the filing of the return. The peculiar position, however, as it obtains in the present case arises out of the fact that the disallowance which was effected by the Assessing Officer has not, the Court is informed, been challenged by the assessee. As a matter of fact the question of law which is formulated by the Revenue proceeds on the basis that the assessed income was enhanced due to the disallowance of the employer's as well as the employees' contribution towards Provident Fund /ESIC and the only question which is canvassed on behalf of the Revenue is whether on that basis the Tribunal was justified in directing the Assessing Officer to grant the exemption under Section 10A. On this position, in the present case it cannot be disputed that the net consequence of the disallowance of the employer's and the employee's contribution is that the business profits have to that extent been enhanced. There was, as we have already noted, an add back by the Assessing Officer to the income. All profits of the 4 (2009) 319 ITR 306 unit of the assessee have been derived from manufacturing activity. The salaries paid by the assessee, it has not been disputed, relate to the manufacturing activity. The disallowance of the Provident Fund/ ESIC payments has been made because of the statutory provisions - Section 43B in the case of the employer's contribution and Section 36(v) read with Section 2(24)(x) in the case of the employee's contribution which has been deemed to be the income of the assessee. The plain consequence of the disallowance and the add back that has been made by the Assessing Officer is an increase in the business profits of the assessee. The contention of the Revenue that in computing the deduction under Section 10A the addition made on account of the disallowance of the Provident Fund / ESIC payments ought to be ignored cannot be accepted. No statutory provision to that effect having been made, the plain consequence of the disallowance made by the Assessing Officer must follow. The second question shall accordingly stand answered against the Revenue and in favour of the assessee. Re Questions c and d : 13. Counsel appearing on behalf of the Revenue and counsel appearing on behalf of the assessee are agreed in stating that these two questions of law will stand covered in favour of the Revenue and against the assessee by the judgment of this Court dated 18/19 March 2010 in Commissioner of Income Tax v. Asian Star Company Limited (ITA 200 of 2009). Both these questions of law are accordingly answered in

the negative in favour of the Revenue and against the assessee. Re Question e : 14. The Tribunal has followed a decision of its Special Bench in coming to the conclusion that foreign exchange earned on the realization of export receipts in a year other than the year in which the goods were exported would have to be considered in the year of export for the purpose of exemption under Section 80HHC. The Tribunal has, however, directed the Assessing Officer, while granting a deduction to the assessee under Section 10A in the year of export to exclude the amount from the profits of the year under consideration simultaneously. This is to ensure that the assessee does not obtain a deduction twice over. 15. For the purposes of the appeal it has not been disputed on behalf of the Revenue that the foreign exchange was realized by the assessee within the period stipulated in law. The assessee realized a larger amount because of a foreign exchange fluctuation. The fact that this forms part of the sale proceeds would have to be accepted in view of the judgment of the Division Bench of this Court in Commissioner of Income Tax v. Amber Export (India) (ITA 1249 of 2007 decided on 18 February 2009). The judgment of this Court in turn followed the decision of the Gujarat High Court in Commissioner of Income Tax v. Amba Impex5. The sole ground which has been urged on behalf of the Revenue in support of the appeal on this issue is based on the judgment of a Division Bench of this Court in Commissioner of Income Tax v. Shah Originals (ITA 431 of 2008 decided on 22 April 2010). The decision in Shah Originals is, however, distinguishable for the reason that the foreign fluctuation in that case arose after the export transaction had been completed and 5 (2006) 282 ITR 144 (Guj) after the export profits were deposited by the assessee in an EEFC Account. This is evident from the following observations : “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 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 80HHC." (emphasis supplied) In the present case, the assessee has realized a larger amount in terms of Indian rupees as a result of a foreign exchange

fluctuation that took place in the course of the export transaction. 16. For the aforesaid reasons, the question of law is answered against the Revenue and in favour of the assessee. The appeal shall accordingly stand disposed of in the aforesaid terms. There shall be no order as to costs. (Dr. D.Y. Chandrachud, J.) (J.P. Devadhar, J.)