Bombay High Court The Commissioner Of Income Tax-8 vs M/S. Pfizer Ltd on 18 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 (LODG.) NO.128 OF 2009

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

M/s. Pfizer Ltd ..Respondent.
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Mr. Vimal Gupta for the Appellant.
Mr. P.J. Pardiwala, Senior Advocate with Mr. Rajiv Singh and Mr.

Sameer Chitnis i/b Chitnis & Co. for the Respondent.
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CORAM : DR.D.Y.CHANDRACHUD &
J.P.DEVADHAR, JJ.

18 June 2010. ORAL JUDGMENT (Per DR.D.Y.CHANDRACHUD, J.) : 1. The Appeal by the Revenue under Section 260-A of the Income Tax Act, 1961 has raised the following questions of law : "A) Whether on the facts and in the circumstances of the case and in law the Tribunal was justified in holding that the insurance claim amounting to Rs.36.22 lakhs related to stock-in-trade of the Assessee Company and therefore there was no justification to exclude 90% of the

insurance claim while computing eligible profits u/s.80HHC of the Income tax Act, even though there is a clear finding of the Assessing Officer that the insurance claim is not directly related to business profit; B) Whether on the facts and in the circumstances of the case and in law the Tribunal was justified in holding that sundry receipts amounting to Rs.28.17 lacs related to activity incidental to the business carried on by the Assessee Company and therefore there was no justification to exclude 90% of the sundry income while computing eligible profits u/s. 80HHC of the Income tax Act, even though the sundry receipts do not have any direct nexus with the pharmaceutical manufacturing activities of the Assessee Company; C) Whether on the facts and in the circumstances of the case and in law the Tribunal was justified in holding that the rental income of Rs.2,85,60,871/- received by the Assessee Company from sub-leasing of commercial premises is to be considered as 'Income from House Property" even though the renting out of the premises amounts to commercial exploitation for business purposes by the Assessee Company and therefore was rightly held to be "Business Income" by the Assessing Officer; D) Whether on the facts and in the circumstances of the case and in law the Tribunal was justified in holding that retrenchment compensation paid to workmen was revenue expenditure;" 2. The dispute in the present case relates to Assessment Year 2000-01. Re : Question A 3. The assessee engages in the manufacture of pharmaceuticals and animal health products. For the Assessment Year in question the assessee claimed a deduction under Section 80HHC. The Assessing Officer, while computing the deduction excluded 90% of the amount of an insurance claim which was related to the stock in trade of the assessee. The Commissioner (Appeals) confirmed the order of the Assessing Officer. The Tribunal noted that for Assessment Year 1998-99 it had come to the conclusion that there was no justification to exclude 90% of the insurance claim. Besides this, the Tribunal held that the insurance claim formed part of the income of the business of the assessee and was liable to be considered as part of the profits of the business in view of Explanation (baa) to Section 80 HHC. The Tribunal was of the view that the insurance claim was not in the nature of brokerage, commission, interest, rent or charges and therefore was not any other receipt of a similar nature within the meaning of Explanation (baa). The Tribunal, therefore, held that 90% of the insurance claim could not be excluded. 4. Counsel appearing on behalf of the Revenue submits that an insurance claim constitutes an independent income which is not relatable to the export turnover. Hence, it has been urged that 90% of the insurance claim is liable to be excluded from the profits of the business under Explanation (baa) to Section 80 HHC. Reliance was sought to be placed in this regard on the judgment of the Supreme Court in Commissioner of Income Tax v. K. Ravindranathan Nair1. On the other hand it was urged on behalf of the assessee that a contract of insurance indemnifies the insured for a loss that has occurred, in the present case to the stock in trade. Learned counsel submitted that the claim for insurance on account of the stock in trade, hence, did not constitute an independent item of income similar to commission, interest, rent, brokerage or other charges. On this foundation it has been urged that the insurance claim would not be susceptible to a deduction of 90% under Explanation (baa). 5.

At the outset it would be necessary for the Court to advert to the judgment of this Division Bench dated 8 April 2010 in the Commissioner of Income Tax v. Dresser Rand India Pvt.Ltd. (Income Tax Appeal 2186 of 2009). The question of law which was 1 (2007) 165 Taxman 282 (SC) formulated in the appeal by the Revenue was as follows : "Whether on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that 90% of recovery of freight, insurance and packing receipts amounting to Rs.49,14,076/-, sales tax set off/ refund amounting to Rs.38,33,148/- and service income of Rs. 2,89,17,545/- are not to be excluded from profits of business within the meaning of clause (baa) of explanation to Section 80HHC of the Act for the purpose of computation of deduction u/s. 80HHC of the Income Tax Act, 1961?" 6. This Court by its decision held that in terms of the judgment of the Supreme Court in Ravindranathan Nair (supra) the issue of processing charges would stand covered by the decision. This Court noted that the Supreme Court had held that the processing charges, though they form a part of the gross total income, constitute independent income like rent, commission and brokerage and that hence 90% of the same had to be reduced from the gross total income to arrive at business profits. The concluding paragraph of the judgment of this Court records the concession of counsel appearing on behalf of the assessee that the discussion in respect of the issue in regard to processing charges as an independent income unrelated to export, would similarly apply to the other issues raised in the question of law framed by the Revenue viz. in regard to recovery of freight, insurance and packing receipts, sales tax refund and service income. The question of law was therefore answered in favour of the Revenue and against the assessee. From this it is apparent that insofar as the insurance claim was concerned, Dresser Rand proceeded on a concession by counsel appearing on behalf of the assessee. That apart, the facts do not contain an elaboration of the nature of the insurance claim in that case. The judgment of the Division Bench in Dresser Rand would therefore not conclude the issue which has fallen for determination in this appeal. 7. Sub section (1) of Section 80HHC contemplates a deduction to an assessee, being an Indian Company or a person resident in India and engaged in the business of export out of India of any goods or merchandise to which the section applies. The deduction is to be allowed in computing the total income of the assessee to the extent of the profits derived by the assessee from the export of such goods or merchandise. Clause (a) of sub section (3) of Section 80HHC provides the formula for determining the profits derived from the export of goods or merchandise to which the section applies. Where the export out of India is of goods or merchandise manufactured or processed by the assessee, the profits derived from such export "shall be the amount which bears to the profits of the business", the same proportion as the export turnover in respect of such goods bears to the total turnover of the business carried on by the assessee. In other words, the proportion between the export turnover and the total turnover of the business is applied to the profits of the business in order to determine the extent to which the profits are to be regarded as being derived from export. 8. It would be necessary to advert to Explanation (baa) which defines the profits of business as follows : "(baa)"profits of the business" means the profits of the

business as computed under the head “Profits and gains of business or profession” as reduced by - (1)ninety per cent of any sum referred to in clauses (iiia), (iiib) and (iiic) of section 28 or of any receipts by way of brokerage, commission, interest, rent, charges or any other receipt of a similar nature included in such profits; and (2)the profits of any branch, office, warehouse or any other establishment of the assessee situate outside India." 9. Under Explanation (baa), the profits of business are defined to mean the profits of business as computed under the head of profits and gains of business or profession. This has to be reduced under Clause (1) by ninety percent of any sum referred to in clauses (iiia), (iiib) and (iiic) of Section 28 which are in the nature of incentive incomes or “of any receipts by way of brokerage, commission, interest, rent, charges or any other receipt of a similar nature included in such profits”. Receipts by way of brokerage, commission, interest, rent or charges have been held, by the judgment of the Supreme Court in Ravindranathan Nair’s case to constitute independent incomes. Being independent incomes unrelated to export, Parliament contemplated that ninety percent of such receipts would have to be reduced from the profits of business as defined in Explanation (baa). The rationale is explained in the following observations of the Supreme Court : “That, profit incentives and items like rent, commission, brokerage, charges etc., though formed part of gross total income had to be excluded as they were”independent incomes" which had no element of export turnover. That, the said items distorted the figure of export profits." Again, in paragraph 21 the Supreme Court observed as follows : “The said clause stated that 90 per cent of incentive profits or receipts by way of brokerage, commission, interest, rent, charges or any other receipt of like nature included in Business Profits, had to be deducted from Business Profits computed in terms of sections 28 to 44D of the Income tax Act. In other words, receipts constituting independent income having no nexus with exports were required to be reduced from Business Profits under clause (baa). A bare reading of clause (baa)(1) indicates that receipts by way of brokerage, commission, interest, rent, charges, etc. formed part of gross total income being Business Profits. But for the purposes of working out the formula and in order to avoid distortion of arriving export profits clause (baa) stood inserted to say that although incentive profits and”independent incomes" constituted part of gross total income, they had to be excluded from gross total income because such receipts had no nexus with the export turnover." 10. In determining in each case as to whether a receipt which forms part of the profits of business is liable to undergo a reduction of ninety percent as stipulated in clause (1) of Explanation (baa), it is necessary for the Court to consider whether the receipt is “of a similar nature included in such profits”. The rationale for excluding ninety percent of the receipts by way of brokerage, commission, interest, rent or charges is that these are independent incomes and their inclusion in the profits of business would result in a distortion. In determining whether any other receipt is liable to undergo a reduction of ninety percent the basic prescription which must be borne in mind is whether the receipt is of a similar nature and is included in the profits of business. To be susceptible of a reduction the receipt must be of a nature similar to brokerage, commission, interest, rent or charges.

11. In the present case, the insurance claim, it must be clarified, related to the stock in trade and it is only an insurance claim of that nature which forms the subject matter of the appeal. Now, it cannot be disputed that if the stock in trade of the assessee were to be sold, the income that was received from the sale of goods would constitute the profits of the business as computed under the head of profits and gains of business or profession. The income emanating from the sale would not be sustainable to a reduction of ninety percent for the simple reason that it would not constitute a receipt of a nature similar to brokerage, commission, interest, rent or charges. A contract of insurance is a contract of indemnity. The insurance claim in essence indemnifies the assessee for the loss of the stock in trade. The indemnification that is made to the assessee must stand on the same footing as the income that would have been realized by the assessee on the sale of the stock in trade. In these circumstances, we are clearly of the view that the insurance claim on account of the stock in trade does not constitute an independent income or a receipt of a nature similar to brokerage, commission, interest, rent or charges. Hence, such a receipt would not be subject to a deduction of ninety percent under clause (1) of Explanation (baa).
11A. Counsel appearing on behalf of the Revenue submitted that the insurance claim has no element of export turnover and that consequently it must sustain a reduction of ninety percent under Explanation (baa). Now it is necessary to note that Explanation (baa) in terms does not refer to export turnover. Sub section (1) of Section 80HHC contemplates a deduction to the extent of profits derived by the assessee from the export of goods or merchandise to which the section applies. The basic issue therefore is to determine the extent of profits derived by the assessee from the export of such goods or merchandise. The formula in sub section (3) of Section 80 HHC has been provided by Parliament, for the purposes of sub section (1) to compute the profits derived from the export of goods. Clause (a) of sub section (3) specifies that where the export is of goods or merchandise manufactured or processed by the assessee the profits derived from the export shall be the amount which bears to the profits of business, the same proportion as the export turnover in respect of such goods bears to the total turnover of the business carried on by the assessee. In other words, in determining the profits derived from the export of goods or merchandise the proportion of the export turnover to the total turnover of the business is applied to the profits of the business. The profits of the business in turn are defined in Explanation (baa) to Section 80HHC. Hence, the element of export turnover is a facet which has been taken care of by the legislature in the application of the formula which is referred to in sub section (3) of Section 80HHC. In determining the profits of the business for the purposes of Explanation (baa), the incomes which are susceptible to a reduction of ninety percent are those which are specifically prescribed by the legislature. These are inter alia the incomes referred to in clauses (iiia), (iiib) and (iiic) of Section 28 and receipts by way of brokerage, commission, interest, rent, charges or receipts of a similar nature included in such profits. Therefore, before a receipt is liable to be excluded to the extent of ninety percent, it must be a receipt of a nature similar to brokerage, commission, interest, rent or charges. For the reasons which we have

already indicated, we have come to the conclusion that the claim on account of insurance for the stock in trade did not constitute a receipt of a similar nature within the meaning of Explanation (baa) and was therefore not liable to be reduced to the extent of ninety percent. The first question will therefore not raise any substantial question of law. Re : Question B 12. Insofar as this question is concerned, it is common ground between counsel appearing on behalf of the Revenue and counsel appearing on behalf of the assessee that there is no discussion in the order of the Tribunal pertaining to the sundry receipts amounting to Rs.28.17 lacs or as regards the nature of those receipts. In these circumstances, we consider it appropriate to restore this issue back to the Tribunal for a decision afresh after hearing the parties. Re : Question C 13. The Tribunal has observed that during the course of Assessment Year 1996-97 the Tribunal had by its decision dated 24 October 2005 restored the issue to the Assessing Officer to examine whether the income could be assessed as income from house property. The Tribunal noted that the Assessing Officer on remand found that the tenancy was not on a month to month basis and that the income had to be assessed as income from house property. The decision, the Court has been informed has been accepted by the Revenue. That being the position, we do not find any reason to hold that the Tribunal was in error and the issue raised would not give rise to any substantial question of law. Re : Question D 14. The assessee which engages in the manufacture and sale of pharmaceutical products had three units at Ankleshwar, Thane and Chandigarh. The assessee entered into a Memorandum of Understanding with its trade union on 16 November 1998 in pursuance of which an amount of Rs.5 lacs was to be paid to each permanent employee upon the closure/ sale of the Ankaleshwar unit. On 24 March 1999 the assessee issued a notice of closure. Thereafter under a supplementary Memorandum of Understanding of 12 July 1999 further ex gratia of Rs.2 lacs was paid to each permanent employee. The Ankleshwar unit was closed down with effect from 31 July 1999. The payment made to the employees inter alia comprised of retrenchment compensation under Section 25(F) of the Industrial Disputes Act, 1947 and payments on account of Provident Fund, gratuity and leave encashment. 15. The Tribunal observed that though the assessee carried out manufacturing activity at various locations, all other support functions such as purchase, sales, marketing, distribution, finance and human resources were centralized with the head office. None of the manufacturing units functioned as independent profit centers. All purchases for the manufacturing units were centralized at the head office. The sales and marketing function was also centralized. The working capital requirements and capital commitments with regard to plant operations were also centralized. The Tribunal has entered a finding of fact that there was interdependence and a unity of control between the three units established by the existence of common management, a common business organization, administration and fund. The closure of the unit at Ankleshwar did not involve the closure of the business. The retrenchment compensation paid to the workmen was therefore an allowable deduction within the meaning of Section 37(1) since there was no closure of the business. 16. In view of the finding that there has been no closure of the business as such, the payments

which were made to the workmen, therefore qualify for a deduction under Section 37. The view of the Tribunal does not suffer from any error. No substantial question of law would arise. The appeal shall accordingly stand disposed of in these terms. There shall be no order as to costs. (Dr. D.Y.Chandrachud, J.) (J.P. Devadhar, J.)