Matrix Laboratories Limited, ... vs Assessee on 25 May, 2012

IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCH 'B', HYDERABAD

Before Shri Chandra Poojari, Accountant Member and
Smt. Asha Vijayaraghavan, Judicial Member

I.T.A. No. 835/Hyd/2005 - A.Y. 2001-02
I.T.A. No. 836/Hyd/2005 - A.Y. 2002-03
I.T.A. No. 837/Hyd/2005 - A.Y. 2003-04

M/s. Matrix Laboratories Ltd., Secunderabad PAN: AAACH2780D Assessee	Vs.	Asst. Commissioner of Income-tax, Circle-2(2), Hyderabad Respondent

I.T.A. No. 938/Hyd/2010 - A.Y. 2002-03
I.T.A. No. 939/Hyd/2010 - A.Y. 2003-04

M/s. Matrix Laboratories Ltd., Secunderabad PAN: AAACH2780D Assessee	Vs.	Deputy Commissioner of Income-tax, Circle 16(2) Hyderabad Respondent

I.T.A. No. 930/Hyd/2005 - A.Y. 2001-02
I.T.A. No. 931/Hyd/2005 - A.Y. 2002-03
I.T.A. No. 932/Hyd/2005 - A.Y. 2003-04
I.T.A. No. 895/Hyd/2010 - A.Y. 2002-03
I.T.A. No. 896/Hyd/2010 - A.Y. 2003-04

The Asst. Commissioner of Income-tax, Circle-16(2), Hyderabad Assessee	Vs.	M/s. Matrix Laboratories Ltd., Secunderabad PAN: AAACH2780D Respondent

Assessee by: Shri K.A. Sai Prasad,
Shri K.V.S. Bhaskar Rao and
Shri Raja Praturi
Revenue by: Shri D.D. Goyal

Date of hearing: 25/05/2012
Date of pronouncement: 02/07/2012

ORDER

PER CHANDRA POOJARI, AM:

These are appeals both by the assessee as well as by the Revenue directed against different orders of different CIT(A)s, Hyderabad.

2. The first common ground in assessee's appeals in I.T.A. Nos. 835 & 836/Hyd/2005 is that the CIT(A) erred in holding that the Assessing Officer was correct in issuing notice u/s 148 and making re-assessment u/s 147 though in terms of the reasons as furnished by the Assessing Officer income has not escaped assessment.

3. According to the learned AR, there is no tangible material in the possession of the Assessing Officer to come to the conclusion for reopening of assessments. According to the assessee to compute deduction u/s. 80HHC r.w.s. 115JB, all the material facts available on record and the Assessing Officer in the re-assessment proceedings has simply taken a computation filed by the assessee as the basis and reworked out the deduction u/s 80HHC of the Income-tax Act, 1961 and worked out the book profit u/s 115JB of the Act. He submitted that there is no fresh material came to the possession of the Assessing Officer. The assessee duly filed a certificate from the chartered accountant in Form 10CCAC for claiming deduction u/s 80HHC of the Act. According to the AR from the date of the assessment order till the date of issue of notice u/s 148 of the Act, no new material came to the possession of the Assessing Officer. Being so, there is no question of reopening of the assessments. He submitted that the re-assessment is not covered by sub-clause (iv), clause (c) of Explanation to section 147 since the main ingredient should be "reason to believe". Even to form this reason, there should be tangible material.

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========== The existence of tangible material is exactly the requisite condition laid down by the Supreme Court in the case of CIT vs. Kelvinator (India) Ltd. (320 ITR 561). The Supreme Court discussed at length on various issues including the provisions as amended by Finance Act, 1989 and the Board Circular No. 549 dated 312.10.1989 and upheld the full bench decision of the Delhi High Court in the case of CIT vs. Kelvinator of India Ltd. (256 ITR 1) (Del) wherein it was held as under:

> "Therefore, post April 1, 1989, power to reopen is much wider. However, one need to give a schematic interpretation to the words "reason to believe" failing which, we are afraid, section 147 would given arbitrary powers to the Assessing Officer to reopen assessments on the basis of 'mere change of opinion', which cannot be per se reason to reopen. We must also keep in mind the conceptual difference between power to review and power to reassess. The Assessing Officer has no power to review, he has the power to reassess. But re-assessment has to be based on fulfilment of certain precondition and if the concept of change of opinion is removed, as contended on behalf of the Dept., then, in the garb of reopening the assessment review would take

> place. Once must treat the concept of 'change of opinion' as an inbuilt test to check abuse of power by the Assessing Officer. Hence, after 1st April, 1989 the Assessing Officer has power to reopen, provided there is 'tangible material' to come to the conclusion that there is escapement of income from assessment. Reasons must have a live link with the formation of the belief."

4. According to the AR unless some fresh material indicating escapement of income has come to the notice of the Assessing Officer no notice u/s. 147 of the Act can be issued. This is so even in cases where simply an intimation u/s. 143(1)(a) of the Act was sent according to the latest decision of Mumbai Bench in the case of H.V. Transmissions Ltd. vs. ACIT in ITA Nos. 2230 and 2476/Mum/2010 dated 7.10.2011. According to the assessee's counsel the judgement of Supreme Court in the case M/s. Matrix Laboratories Ltd.

========== of Rajesh Jhaveri Stock Brokers (P) Ltd., 291 ITR 500 is not applicable to the facts of the case. More so, the same was considered by the Mumbai Bench while adjudicating similar issue in the case of H.V. Transmissions Ltd. (supra). He relied on the judgement of Delhi High Court in the case of P.C. Puri vs. CIT, 151 ITR 584. According to the learned AR, there is no tangible material justifying the reopening of assessment to say that there is escapement of income. He relied on the order of the Tribunal in the case of Telco Dadaji Dhakjee Ltd. vs. DCIT in I.T.A. No. 4613/Mum/05 dated 12th May, 2010.

5. On the other hand, the learned DR strongly opposed the argument of the learned counsel for the assessee and submitted that there was no assessment in this case u/s. 143(3) of the Act. Being so, there is non consideration of issue relating to deduction u/s. for export profits under 115 JB of the Act. He relied on the judgement of Supreme Court in the case of Rajesh Jhaveri Stock Brokers (P) Ltd. (supra). Further he relied on the judgement of Madras High Court in the case of Areva T. and D India Ltd. vs. ACIT (294 ITR 233) for the proposition that if there is any procedural irregularities in completing the re-assessment it does not invalidate the assessment order. He also relied on the judgement P & H High Court in the case of Sunil Bhaseen vs. CIT (179 Taxman 148) for the proposition that the Department was under no obligation to dispose of objection of the assessee to the initiation of proceedings, by way of separate and independent order unless the findings of the Assessing Officer are not pervert in any manner. He also relied on the order of the Tribunal in the case of Elegant Chemicals Enterprises Vs, ACIT (271 ITR 56 (AT)(HYD) wherein held that reopening I s alid in law where the return of income was merely processed under section 143(1) of the Act and when the M/s. Matrix Laboratories Ltd.

========== assessing officer is of the opinion that income chargeable to tax has escaped assessment.

6. We have heard both the parties and considered the material available on record. In this case there is no assessment u/s. 143(3) of the Act and only the return was processed u/s. 143(1) of the Act. The reopening of the assessment is within four years from the end of the relevant assessment year. As per clause (b) of Explanation 2 to proviso to section 147 where a return of income has been furnished by the assessee but no assessment has been made and it is noticed by the Assessing

Officer that the assessee has understated the income or has claimed excessive loss, deduction, allowance or relief in the return, the Assessing Officer is entitled to reopen the assessment. Further in the case of ACIT vs. Rajesh Jhaveri Stock Brokers (P) Ltd. (supra), it was held that the Assessing Officer is having jurisdiction to issue notice u/s. 148 for bringing to tax income escaping assessment on the ground that the assessee claimed excessive relief or deduction. In the present case considering the excessive claim of the assessee u/s. 80HHC while computing the Book Profit u/s 115JB of the Act, the Assessing Officer initiated the reopening of assessment to bring the income to tax which is escaped from assessment. Being so, we are of the opinion that reopening of assessment is valid.

7. We have also carefully gone through the order of the Mumbai Bench of the Tribunal in the case of H.V. Transmissions Ltd. (supra). In this case the assessee incurred expenses towards Enterprise Resource Planning software amounting to Rs. 95.14 lakhs. In the accounts the assessee has debited 25% of this amount i.e., Rs. 23,78,500 whereas in the computation of income, the assessee has claimed the entire M/s. Matrix Laboratories Ltd.

========== amount of Rs. 95.14 lakhs as deduction. The expenses incurred by the assessee is payment for acquisition of software which is capital in nature. Hence the assessment is reopened to disallow the same. On appeal to the Tribunal, it was held that there was no material coming to the possession of the Assessing Officer on the basis of which the assessment completed u/s. 143(1) was reopened and this position has not been disputed even by the DR. Being so, in the present case we are not in a position to apply the ratio laid down by that decision because clause (b) to Explanation 2 to proviso 2 of section 147 clearly authorises the Assessing Officer to reopen the assessment. This provision is to be considered for the purpose of adjudicating this issue. This ground relating to reopening of assessment is decided against the assessee.

8. The next ground in I.T.A. Nos. 835 and 836/Hyd/2005 is that the CIT(A) further erred in holding that the re-assessment order under section 147 is in order though the Assessing Officer did not follow the procedure laid down by the Supreme Court in the case of GKN Drive Shafts (India) Ltd. (2003)(259 ITR 19) thereby rendering the proceedings and the order defective, on the ground that the breach made by the Assessing Officer is a mere procedural error. This ground is not pressed before us and the same is dismissed as not pressed.

9. The next common ground in assessee's appeals in ITA Nos. 835, 836 and 837/Hyd/2005 for A.Ys. 2001-02 to 2003-04 is that the CIT(A) erred in not allowing 100% deduction in respect of export profits under clause (iv) of Explanation to section 115JB while computing book profits by holding that the provisions of subsection (1B) of section 80HHC with regard to phasing out of benefits are applicable even in respect of deduction under clause (iv) of Explanation to section 115JB.

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========== The Revenue also raised the ground in ITA Nos. 930 to 932/Hyd/05 with regard to direction of CIT(A) appeal to Assessing Officer to compute the deduction u/s. 80HHC by adopting the book profit in place of the profits of the business while

computing the chargeable book profit u/s. 115JB.

10. We have heard both the parties on this issue. This issue is common in all these appeals. While the assessee contests the CIT (A)'s order for not allowing deduction under clause (iv) of' Explanation on the entire amount of export profits computed from the base of book profits but instead restricting the deduction in terms of the phasing out per sub-section (1B), the Department is disputing the order of the CIT(A) for computing the deduction based on book profits instead of the amount as computed under section 80HHC based on profits of the business under clause (baa). The assessee relies on the recent decision of the Supreme Court in the case of Ajanta Pharma Ltd v CIT (2010) (327 ITR 305). The assessee submitted that the Apex Court has approved the Special Bench decision of ITAT in DCIT v Syncom Formulations (I) Ltd. (2007) (106 ITD 193).

11. The DR fairly conceded that the decision of the Supreme Court in the case of Ajanta Pharma (supra) is against the Department and in favour of the assessee. The Apex Court laid down the law that for purposes of computing book profit, the deduction to be allowed under clause (iv) of Explanation is the export profits as computed with reference to book profits. Sec. 115JB is a separate code for company assessees' for computing minimum tax payable in the absence / inadequacy of normal taxable income falling under the 5 heads of income. The minimum tax is to be computed with reference to book profits as per the audited accounts of the company. Consequently the export profits computed under the provisions of sec. 80HHC M/s. Matrix Laboratories Ltd.

========== based on 'profits of business or profession' cannot be substituted into the computation scheme as prescribed in sec. 115JB which is an alternative computation to the normal computation of income. The Court also held that the deduction under clause (iv) of Explanation for the export profits should not be phased out as provided in sub-section (1B) of sec. 80HHC because, 115JB is an independent code and it covers full export profits as the eligible profits for the purposes of book profits tax and no phasing is required to be carried out. This view has been reiterated by the Apex Court in the recent case of CIT v Bhari Information Tech. Sys. P. Ltd in Civil Appeal No. 33750/2009 rendered on 20.10.2011. Thus, this ground in assessee's appeals ITA Nos. 835 to 837/Hyd/05 is allowed and related ground in Revenue appeals in ITA Nos. 930 to 932/Hyd/05 is dismissed.

12. The next ground in ITA No. 837/Hyd/2005 for A.Y. 2003- 04 is that the CIT(A) erred in holding that deferred tax provision made pursuant to Accounting Standard 22 is an unascertained liability and hence warrants adjustments by way of addition to the book profits in terms of clause (c) as well as clause (a) of the Explanation to section s. 115JB of the Act.

13. Brief facts of the issue are that while arriving at the book profits, the assessee did not add back deferred tax of Rs. 14,72,44,834 to the net profit as per profit and loss account, which according to the Assessing Officer is required to be added back in terms of clause (a) of Explanation to section 115JB. In support of its stand, the AR has, both before the CIT(A) and during the assessment proceedings argued that Explanation (a) to section 115JB requires addition of the amount of Income-tax paid or payable and provision therefor. Section 2(43) of the Act defines "tax" to mean income tax chargeable under the M/s. Matrix Laboratories Ltd.

========== provisions of this Act. Since section 2(43) specifically uses the word "means" the definition of tax is exhaustive and cannot be interpreted beyond the scope of the definition as specified in the Act. Thus a joint reading of section 2(43) and section 115JB clearly specifies tax to mean tax as per the Act only. Therefore, the words "provision" appearing in Explanation (a) to section 115JB(2) has to be construed only as provision in relation to income-tax as defined under section 2(43) of the Act. Further, provision for deferred tax is not payable and, therefore, cannot be roped in clause (a) of the Explanation. The AR further argued that CBDT while issuing explanatory notes to Finance Act, 2000 vide Circular No. 794 dated 9th August, 2000 clarified that 'the new provisions further provide that for purposes of MAT, the company shall follow same accounting policies and standards as are followed for preparing its statutory account". Provision for deferred tax is made in terms of Accounting Standard-22, a mandatory requirement in terms of section 211(3C) of the Companies Act, 1956 for computing book profits'. The Assessing Officer rejected the stand taken by the assessee on the following reasons:

> 13.1 The provision for deferred tax comes after the profit has been determined in accordance with parts-II and III of schedule-

VI to Companies Act, 1956 and no adjustment by way of reduction of such a provision from the net profit has been provided for in section 115JB. In response, the AR argued that Accounting Standard-22 clearly specifies that tax expense for the period comprising current tax and deferred tax should be included in the determination of the net profit or loss for the period. Therefore, once the deferred tax is included in the net profit for the period, one cannot go beyond net profit as per profit and loss account and make adjustments for the same when not specifically provided for by the explanation to M/s. Matrix Laboratories Ltd.

========== section 115JB. Reliance is placed on the decision of the Supreme Court in the case of Apollo Tyres Ltd. v. CIT (255 ITR

273).

13.2 The Assessing Officer further stated that the assessee in its own case for earlier Asst years has adopted the figure of profit before tax as the starting point for computation and did not reduce the provision for deferred tax for computation of taxable Book Profit u/s 115JB. In response, the AR argued that the Assessing Officer has failed to appreciate that the concept of res judicata does not apply to income tax proceedings, more so when the issue involved is related to deductibility or otherwise of an item of expenditure.

13.3 The Assessing Officer argued that the deferred tax liability is subject to future uncertainties both in taxing statutes as well as the accounting policies to be adopted by the company in future and, therefore, is an unascertained liability covered by clause (c) of Explanation to section 115JB. In response, the AR argued that the Assessing Officer's contention that the provision for deferred tax is an unascertained liability is far from truth. Accounting Standard-22 'Accounting for Taxes on Income' details a comprehensive methodology with regard to computation of deferred tax arising from timing differences on account of taxable income and accounting income. By no stretch of

imagination can one conclude that the provision is unascertained.

13.4 The Assessing Officer argued that the adjustment in terms of Explanation to section 115JB requires not only adding the amounts pertaining to provision for income tax for the current year but also future Income tax liabilities arising out of the timing differences between the Income-tax M/s. Matrix Laboratories Ltd.

========== Act and regular accounting policy followed by the assessee. The AR submitted before the CIT(A) that in terms of the Accounting Standard-22, the provision for current tax is independent of provision for deferred tax. The standard requires separate computation under each i.e., provision for current tax and deferred tax as well as separate disclosure of each. Current tax is always worked out on the taxable profits of the year under consideration and has no bearing whatever on the quantum of deferred tax. Deferred tax charged/credited to the profit and loss account is an accounting entry to adhere to the principle of matching concept. The DR relied on the order of the lower authorities.

14. We have heard both the parties on this issue and perused the material available on record. In our opinion, after insertion of clause (h) in the Explanation-1 to section 115JB with retrospective effect vide Finance Act, 2008 with effect from 1.4.2001, this issue has to be decided against the assessee as this clause reads as follows:

> "(h) - The amount of deferred tax and the provision therefor."

15. In view this clause the book profit shown in the Profit and Loss Account in the relevant previous year prepared under sub- section (2) of section 115JB to be increased, inter alia by the amount of deferred tax and the provisions therefor. Hence this ground is rejected.

16. The first ground in ITA Nos. 938 & 939/Hyd/2010 is as under:

> "The CIT(A) erred in rejecting the appellant's contention that the re-assessment u/s 147 of the Income-tax Act, 1961 to reduce the entire brought M/s. Matrix Laboratories Ltd.
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> ========== forward business loss & allowances for computing relief u/s. 80HHC of the Act is invalid and time barred as there is no failure on the part of the appellant to disclose all material facts relevant for assessment."

17. The learned AR submitted that in this case, the original assessment was completed u/s 143(3) on 31.03.2005 and notice u/s 148 was issued on 05/02/2008 to re-compute the deduction u/s 80HHC, in the computation u/s 115JB, without any fresh tangible material warranting the initiation of proceedings u/s 148. It is a mere change of opinion. As held by the Apex Court in the case of CIT vs. Kelvinator of India Ltd (320 ITR 561), the action of the Assessing Officer is not justified, even though the notice u/s 148 was issued before expiry of 04 years from the end of the relevant assessment year. The facts of the case of the assessee are exactly similar to the facts of the cases of

CIT vs Kelvinator of India Ltd (Supra) and the Asian Paints Ltd, (308 ITR 195). Therefore, it is prayed that the Hon'ble ITAT be pleased to hold that the proceedings u/s 147 of the Act initiated on 06.02.2008 for the assessment year 2003- 04 are invalid following the ratio laid down by the Supreme Court in the case of CIT vs. Kelvinator of India Ltd (supra).

17.1 It is further submitted that for assessment years 2001-02, 2002-03 and 2003-04, the assessments were re-opened to re- compute export profits under clause (iv) of Explanation to Section 115JB by adopting profits of the business under clause (baa) of Section 80HHC in place of book profits. After re-opening the assessment, the Assessing Officer has made some. other additions and disallowances which have come to his knowledge in the course of re-assessment proceedings. The action of the Assessing Officer in computing deduction under clause (iv) of Explanation to Section 115JB by adopting the profits of M/s. Matrix Laboratories Ltd.

========== business under clause (baa of section 80HHC is no longer correct as held by the Hon'ble Supreme Court in the case of Ajantha Pharma Pvt. Ltd vs CIT (327 ITR 305). This decision of the Apex Court was followed by the first appellate authority and re-computation worked out by the Assessing Officer was held as invalid by the first appellate authority. Hence, it has now become final that the reasons for re-opening the assessment no longer survive. In such circumstance, it is humbly submitted that the other additions and disallowances made by the Assessing Officer in the case of re-assessment proceedings do not survive equally.

17.2 He drew our attention to the judgment of the Delhi High Court in the case of Ranbaxy Laboratories Limited vs. CIT (336 ITR 136), wherein it was held that the Assessing Officer was not justified when the reasons for initiation of the proceedings ceased to survive. Similar view was taken by the Bombay High Court in the case of CIT vs. Jet Airways (331 ITR 236) (Bom). As held by the Bombay High Court in the case of Rallis India Ltd Vs ACIT (323 ITR 54 Bombay) it is well settled that, law as laid down by the Supreme Court is declaratory of the position as it always stood. Decision of Supreme Court in the case of Ajanta Pharma P Ltd (Supra) is a position deemed as it always was. Hence, the main reason to reopen i.e., reworking deduction u/s 80HHC r.w.s 115JB is not permissible at any time and therefore the other issues in the re assessment proceedings automatically fail and cannot survive.

17.3 Placing reliance on the above three decisions, we humbly submit that since the very reason for re-opening the assessment ceases to survive, the other additions and disallowances made are not justified and may be cancelled.

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18. The learned DR relied on the order of the CIT(A).

19. We have heard both the parties and perused the material on record. In these Assessment Years, assessments have been reopened after four years from the expiry of the assessment year, though the

original assessments have been completed u/s 143(3) of the Act. The assessing officer has considered all the materials available on the record at the time of completing the original assessment and granted deduction u/s 80HHC of the Act. The assessments were reopened on account of excess grant of deduction u/s 80HHC of the I.T Act by virtue of non deduction of brought forward business losses. The assessee having furnished these details of brought forward business losses at the time of original assessment and there is no failure on the part of the assessee to disclose these facts to the assessing officer for the purpose of completion of original assessment. The assessing officer is precluded to reconsider the same after four years from the epxiry of the original assessment year to consider the same to bring the escaped income into taxation. Had it been within four years, the assessing officer could have reopened the assessment under clause (b) to explanation 2 to proviso 2 of Section 147 of the I.T. Act. In these assessment years, the assessment was reopened after four years, in our opinion, the reassessment is bad in law. Even otherwise, even on merit the issue raised in the reassessment is decided by various Courts in favour of the assessee which is evident from the various case laws cited by the learned AR in earlier paras narrated. Further, Delhi High Court in its latest judgment in the case of CIT Vs. Purolator India Ltd. (343 ITR

155) (Delhi) wherein held as follows:

> " In the instant case Explanation 1 to section 147 does not help the revenue. The expression 'material facts' in Explanation 1 refers to primary facts. The term 'primary facts' or 'material facts' are those facts which are material and relevant for the decision of M/s. Matrix Laboratories Ltd.
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> ========== the question before the assessing officer and non-disclosure of which would have a material bearing on the question of escapement of income from assessment. Whether or not 'primary facts' have been disclosed is normally a question of fact and depends upon the facts and circumstances of each case. The requirement of Explanation 1 to section 147 is that there should be full and true disclosure of the primary or material facts and not beyond that. It is the obligation of the assessee to disclose fully and truly the primary facts. It is not the obligation of the assessee to indicate the state what legal inference can be drawn from the primary facts. (para 8).
>
> In the instant case, there is no indication that the assessee had failed or omitted to disclose the material or primary facts. These were available on record. The assessing officer had failed to draw correct legal inference at the time of original assessment from the said primary facts. This is not an error or omission on the part of the x. it is not alleged that the assessee had suppressed, misrepresented or falsified the record/facts. It is not alleged that there was any subsequent factual information on the basis of which it was found that the assessee had not fully disclosed the primary facts or had falsified or disclosed incorrect primary facts (para 10).
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> In view of above, the Tribunal has correctly understood the facts and rightly appreciated the law and applied the same to the factual matrix of the instant case.

There is no reason to entertain the instant appeal and thus, the same is to be dismissed..

20. Being so, we inclined to cancel the reassessment order in these two assessment years. This ground of the appeal is allowed in assessee appeal 938/Hyd/10 and 939/Hyd/2010 for the assessment years 2002-03 & 2003-04 respectively.

21. The next ground in ITA Nos. 938 & 939/Hyd/2010 is that the CIT(A) erred in upholding that the entire brought forward losses and allowance should be reduced while computing deduction towards export profits u/s 80HHC; as against the M/s. Matrix Laboratories Ltd.

========== assessee's claim for pro-rata reduction of the same based on proportion of previous years' losses and allowances attributable to those years' export turnover.

22. The learned AR submitted that the assessee contended that brought forward losses & depreciation allowance should first be prorated as between export business and other business of each of the assessment years to which such loss relates, and only then to reduce such prorated export loss / allowance from the profits of the export business for the current assessment year before computing deduction under sec. 80HHC In terms of sub-section (1) of sec. 80HHC an assessee engaged in the business of export of any goods or merchandise other than those specified in sub-sec (2) thereof is permitted deduction of export profits as per the grading specified in sub-section (1 B). The export profits are computed in accordance with the methodology prescribed in sub-section (3). Clause (b) of sub- section (3) states that where export relates to trading goods, the profit would be computed by deducting from the sale proceeds of such traded goods or merchandise, the cost of such goods as well as other direct and indirect costs. For other cases, clause

(c) of sub-section (3) states that from out of the total profits of the business, the profits from trading goods are reduced to arrive at the adjusted profits and the proportion of export turnover (excluding traded export turnover) to the total turnover (excluding traded export turnover) is multiplied with the adjusted profits to arrive at the export profits which are referred to in sub-section (1). The export profits so derived are subjected to the yearly grading as specified in sub-section (1 B). Clause (baa) of Explanation declares that the profits of the business for the purpose of arriving at the pro-rata export profits is the profit as computed under the head 'income from business or profession' (sec. 28 to 44D of the Act). Section 80HHC carries M/s. Matrix Laboratories Ltd.

========== provision for certain other aspects of export business like supporting manufacturers, DEPB scheme, duty drawbacks, cash assistance scheme etc, which are not relevant for the assessee's case in hand.

a. Section 80HHC is contained in Chapter VIA. Section 80AB governs the computation of deductions specified under the head 'C- deductions in respect of certain incomes' of Chapter VIA. In terms of the provisions of sec 80AB, it is clear that for the purpose of claiming/ allowing deduction under any of the sections (including sec. 80HHC) included in chapter VIA:

• Provisions of, Section 80AB shall override / prevail over the provisions of each and every one of the sections under the heading 'C- deductions in respect of certain incomes' • The legislature intended to restrict the deduction under each of the relevant sections to the income of the nature specified in that section alone to the exclusion of income from any other nature.

• The specified nature of income shall be deemed to be the only amount of income and computed in the same manner as the gross total income of the assessee is computed. In other words, the specified nature of income would be arrived at by adopting the schema of the computational sections of the Act with reference to that specified nature of income alone.

• The relief to be granted under each of the sections as contained in Chapter VIA shall be with reference M/s. Matrix Laboratories Ltd.

========== to the income so computed in the earlier step in respect of that nature of income alone and not income of any other nature.

b. From the above, it follows that, deductions under each of the relevant sections of the chapter shall be computed with reference to income derived from the specified nature to be the only amount of income and the assessee cannot claim a higher deduction than what is related to the specified nature of income by including incomes of any other nature. Likewise, it also follows that an assessee is not bound to include negative income of any other nature, which would result in he being entitled to a deduction which is less than the amount of deduction related to the specified nature of income. Further, income for each nature has to be independently computed in accordance with the provisions of the Act, meaning thereby that the provisions of the Act relating to computation including set off are to be applied in respect of each specified income of such nature separately.

c. The Hon. Supreme Court in the case of IPCA Laboratories Ltd v DCIT (266 ITR 521) (2004) held that the deduction under sec. 80HHC is with reference to export profits alone and that for the purposes of arriving at the said export profits, the profits earned from self- manufacturing as well as trading of goods have to be combined and losses from one have to be adjusted against profits of the other. The Court said that sec. 80AB overrides the provisions of sec. 80HHC and that the latter is not a complete code by itself. The apex Court in the case of ITO v Indoflux Products P. Ltd (280 ITR 1) (2006) declared that the sole objective of sec. 80HHC is to M/s. Matrix Laboratories Ltd.

========== provide incentive for the export business of the assessee whether from export of self-manufactured goods or trading of goods, provided the business results in profits. The underlying theme in both these decisions being that the deduction under sec. 80HHC is only for the profits derived from

export activity. The Board vide its Circular No. 621 dated 19-12-1991 while explaining the provisions relating to Finance (No. 2) Act, 1991 at paragraph 32.5 clarified that under the provisions of sub-section (3) of sec. 80HHC profit derived from the export of goods is computed by multiplying the profits of the business with the proportion of export turnover over total turnover.

d. The Hon. Supreme Court vide its decision reported as CIT v Shirke Construction Co. Ltd, (2911TR 380) (2007) reversed the decision of Bombay High Court while examining the reference in relation to (a) sec. 80HHC is not governed by the provisions of sec. 80AB and (b) whether for determination of profits under sec. 80HHC unabsorbed business losses of earlier years under sec. 72 should be set off? The court relying on its own decisions in IPCA and Indoflux allowed the revenue appeal on both the grounds but did not deal at length with the aspect of extent of brought forward losses that need to be set off from the export profits for computing the relief. The assessee submits that the Hon. Court was not called upon .to decide whether for the purposes of computing relief under export profits, the entire brought forward losses should be deducted or merely those brought forward losses that relate to export activity should be deducted.

e. It is not the case of the assessee that brought forward losses / allowance should not be deducted from M/s. Matrix Laboratories Ltd.

========== the gross total income. There is no dispute that for the purposes of arriving at the gross total income under the Act, the incomes under each of the 5 heads should be aggregated and the brought forward losses / allowances should be reduced to arrive at the GTI. If gross total income is not positive, then the assessee has no claim for benefits under Chapter VIA in terms of sub-sec (2) of sec. 80A of the Act. If the gross total income is positive and provided that the assessee has the income of the nature as specified in each of the sections under the head C of Chapter VIA, he would be eligible to claim deduction as conceived by the said section. Reference is invited to the decision of the Supreme Court in the case of Synco Industries Ltd v AO (299 ITR 444) which has laid down the above rationale. Division Bench of ITAT, Mumbai in the case of Meera Cotton and Synthetic Mills P. Ltd v ACIT (318 ITR (AT) 64) (2009) gave a detailed interpretation (in paragraph 10 at page 69 of the ITR(AT)) which supports the position detailed above by the assessee.

f. It is submitted that the income eligible for deduction under sec. 80HHC to be considered is only in respect of that derived from export of eligible goods or merchandise. The emphasis in the section is on income derived from export of eligible goods or merchandise clearly differentiating it from income derived from domestic sales of eligible goods or merchandise. On a reading of sec. 80AB which applies to all the sections under Chapter VIA-C, the deduction under section 80HHC shall be restricted to the income of the specified nature, such income being computed in accordance with the provisions of the Act. Therefore, all the provisions of the Act as are applicable to the computation of 'profits M/s. Matrix Laboratories Ltd.

========== and gains of business' including those relating to set off and carry forward of business loss and unabsorbed depreciation, shall be considered while computing the income of the specified nature, deeming it to be the only nature of income. In the present case, the income relates to export of eligible goods or merchandise. Consequently, for the purposes of computing deduction under sec. 80HHC it is only the profits and gains of business pertaining to export of goods shall be considered and brought forward loss including depreciation pertaining to export business shall only be set off for arriving at the profits and gains. Any other business loss including brought forward loss / depreciation of the assessee but pertaining to income of different nature shall not be considered.

g. Section 80HHC permits deduction of export profits derived by an assessee subject to conditions stipulated therein. Sub-section (3) thereof provided a mechanism to compute such export profits. Sub-section mandates that such export profits shall be computed by prorating the total profits of the business in proportion to export turnover by total turnover. Once the export profits are computed, the domestic profits are completely ignored and the assessee is entitled to deduction of such export profits in terms of sub-section (1) read with sub-section (1 B). Interpreting the provisions of 80AB and 80HHC one can harmoniously deduce that the income of the assessee is derived from two different natures, one being from export sales and other being from domestic sales. The profits derived from export activity alone are entitled to deduction u/s 80HHC. In view of the abovementioned provisions of section 80AB, for the purpose of arriving at M/s. Matrix Laboratories Ltd.

========== the quantum of deduction u/s 80HHC, the profits/ losses derived from domestic turnover cannot be considered, since the said section requires that deduction to be confined only to profits / losses derived from exports being the nature of income as is specified in the relevant section.

h. It is further submitted that sec. 80HHC deals exclusively with export profits whether from sale of self- manufactured goods or from trading of goods. Once the formula as given in sub-section (3) of the section is applied, the domestic profits are isolated. Therefore, it does not concern itself with domestic profits. If the assessee earned huge profits under the head 'profits and gains of business' but if the proportion of exports is lower as compared to total sales, the export profits for the purposes of sec. 80HHC would be computed at a lower figure and vice versa. Madras High Court in the case of CIT v M. Gani and Co. (301 ITR 381) (2008) while approving its own decisions in the case of CIT v Rathore Brothers (254 ITR 656) and CIT v Macmillan India Limited (295 ITR 67) held that where separate accounts are maintained by an assessee for export and domestic activities, the profits I losses from domestic activities would be omitted for the purposes of arriving at the benefit under sec. 80HHC. In the present case too, the formula prescribed under clause © of sub-sec (3) is merely to facilitate the derivation of export profits, if assessee maintained composite accounts for both activities. It is submitted that the law would not distinguish in the quantum of relief to be granted under a section of the Act, as between an assessee who maintained separate books and another who maintained composite books. The M/s. Matrix Laboratories Ltd.

========== formula as specified in clause © is merely to address the situation where composite accounts are maintained. On application of the above formula to the 'profits of business' as per clause (baa) after subjecting them to certain exclusions towards passive income like rent, interest etc., the export profits are computed on the basis of which deduction under sec. 80HHC is allowed.

i. Since deduction u/s 80HHC is allowed only in respect of profits derived from exports (being specified nature of income to which section 80HHC applies), the quantum of such profits should be arrived at by deducting from the export profits of the business so much amount of brought forward loss I depreciation as is attributable to export turnover of the relevant assessment year to the total turnover of the relevant assessment year. In other words the amount of brought forward loss I depreciation that has to be set off from export profits of the current year shall be an amount which bears the same proportion as the export turnover of the relevant previous year bears to the total turnover of the said previous year(s).

j. As a corollary, only the brought forward losses relating to export activity should be deducted and not the entire brought forward losses from the earlier year. This view is also consistent with the provisions of sec. 80AB which declare that deduction under each of the sections of Chapter VIA should be computed with reference to the nature of profits dealt in the said section. Section 80HHC deals with export profits and therefore, for the purposes of computing export profits, the extent of export losses only be deducted and not the total losses.

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========== k. He tried to explain the issue with an example as follows:

> In the example, the assessee has made business loss I tax depreciation of Rs. 20 in the first year (Year 1) on a turnover of Rs. 100 while in the next year (Year 2) he made a profit of Rs. 60 on a turnover of Rs. 125. Since his export turnover is Rs. 50 in the second year and as he has a gross total income of Rs. 40 (Rs. 60 less b/f loss of Rs. 20) he sought to claim deduction under sec. 80 HHC.
>
> Year 1 Year 2 (Rs) (Rs) 1 Total Turnover 100 125 2 Export Turnover 30 50 3 Profits / Loss for the year (20) 60 Income from the head 'Income from business/ profession' 5 Gross total income of the year 40 = (60-20) 80HHC deduction allowed by AO (by virtue of arriving at the income under 16 = ((60- 6 head 'income from business I
>
> 20)*50/125) profession' at Rs. 40 instead of Rs. 60 adopted by Assessee) Export profit under sub-section (3) of sec. 7 24 = (60x50/125) 80HHC as per Assessee Loss to be reduced for 80HHC as contended by assessee (by computing pro- 8 rata loss of the preceding year on the basis (6) = (20x30/100) of ET/TT of Year 1 and reducing it from 'Income from the 80HHC deduction claimed by Assessee (7-8) l. If the working as adopted by the AO is considered the deduction under sec. 80HHC works out to Rs. 16. The AO adopted the Year 2 proportion of ET/TT for reducing the brought forward

> business loss of Rs. 20. On the other hand the assessee submits that the correct method to be adopted is to first arrive at the profits of the business of the year in terms of clause (baa) and thereafter arrive at the export profits of the year in terms of sub-clause (c) of M/s. Matrix Laboratories Ltd.

========== sub-section (3) of sec. 80HHC. Lastly, in terms of sec. 80AB the export profits so arrived should be reduced not by the entire brought business loss of Rs. 20 but only that which is in proportion to export turnover / total turnover of the Year 1.

m. The assessee draws support from the landmark judgment of ITAT Mumbai Bench in the case of SKF Bearings India Ltd., v JCIT (reported in Vol 4 of Selected orders of ITAT at Page 534)(2005) which has discussed the apex Court judgment of IPCA Labs as well as the Bombay High Court judgment in the case of Shirke Construction Equipment Ltd, (246 ITR 429) at length and after interpreting the provisions of sec. 80HHC read with sec. 80AB held as under: (Relevant extracts):

23. After this decision Hon'ble Supreme Court in IPCA Laboratories Ltd. case (supra) considered the question of applicability of section 80AB. They observed as under:-

> "Section 80AB is also in chapter VI-A. It starts with the words "where any deduction is required to be made or allowed under any section of this Chapter".

This would include section 80HHC. Section 80AB further provides that "notwithstanding anything contained in that section". Thus section 80AB has been given an overriding effect over all other sections in chapter VI-A. Section 80HHC does not provide that its provisions are to prevail over section 80AB or over any other provision of the Act. Section 80HHC would thus be governed by section 80AB. The decisions of the Bombay High Court and the Kerala High Court to the contrary cannot be said to be the correct law. Section 80AB makes it clear that the computation has to be in accordance with the provisions of the Act. If the income has to be computed in accordance with the provisions of the Act, then not only profits but also losses have to be taken into consideration."

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24. Thus according to Hon'ble Supreme Court section 80AB has been given an overriding effect over the sections in Chapter VI-A including section 80HHC. Section 80HHC does not provide that its provisions will prevail over section 80AB. Hon'ble Supreme Court considered that the decisions of Hon'ble Bombay High Court in Shirke Construction Equipments Ltd.'s case (supra) and Kerala High Court decision in Smt. T C. Ushe's case (supra) which were cited by the Ld. Counsel for the assessee in IPCA Laboratories Ltd.'s case (supra) and as mentioned in the report on page 528 in the above decision, they are not the correct law. Even though the decision in IPCA Laboratories Ltd. 's case (supra) was on the question as to whether profit in export of goods manufactured by the assessee can be adjusted against loss in export of trading goods, in the same year and thus resulting in net loss and thereby not allowing deduction u/s 80HHC of the Act, Hon'ble Supreme Court had said

that provisions of section 80AB would prevail over all the section in chapter VI-A. It means that deduction u/s 80HHC will be allowed on the basis of net profit after adjustment of losses of export against profits of another export business. Thus, whereafter such adjustment of losses from one export business against profit of another export business in the same year, there is a loss, then no deduction u/s 80HHC can be allowable. The question regarding set off of brought forward loss against current year's profit was not, in fact, before Hon'ble supreme Court in IPCA Laboratories Ltd.'s case (supra) but a clear decision is given by the Apex Court that Hon'ble Bombay High Court's decision in Shirke Construction Equipment Ltd. 's case (supra) and Kerala High Court's decision in Smt. TC. Usha's case (supra), which held that section 80HHC is a complete code in itself and section 80AB cannot override section 80HHC is not a correct law. Therefore, we are bound by the M/s. Matrix Laboratories Ltd.

========== decision of superior court in IPCA Laboratories Ltd. 's case (supra) ie, Hon'ble Supreme Court. Hon'ble M.P. High Court in Vippy Solver Products Ltd. case (supra), analysed IPCA Laboratories Ltd. 's case (supra) as under: -

> "In our opinion, the question in so far as the assessment year 1986-87 is concerned; it is squarely covered by the decision of the Supreme Court rendered in the case of IPCA laboratory Ltd. (2004) 266 ITR 521 against an assessee. Indeed once it is held that the loss has to be adjusted against the profit then it logically follows that loss of earlier year has got to be set off against the current year profit even for the purpose of deductions u/s 80HHC."

Thus, relying on the above decisions, we hold that brought forward losses have to be adjusted to arrive at profit for the purpose of computing deduction u/s 80HHC. In this connection, one more, intricately connected issue has been raised by learned counsel for the assessee, i.e., whether all types of losses from business brought forward from earlier yeas has to be adjusted against export profit of current year, or only brought forward losses from export business alone have to be considered for set off against export profit of current year. The answer to this question can also be found in IPCA Laboratories Ltd. 's case (supra). Hon'ble supreme Court observed in IPCA Laboratories Ltd. 's case (supra) (page 531 of the report) that:

> "Another reason why the arguments of Mr. Dastur cannot be accepted is that even u/s 80HHC(3)(c)(i), the profit is to be the adjusted against profit of business. The adjusted profit of the business means a profit as reduced by the profit derived from business of exports out of India of trading goods. Thus, in calculating the profits, under sub-section (3) ©(ii) , one necessarily has to reduce by profits under sub-section (3)©(ii) As seen above, the term "profit"

means positive profit. Thus, if there is loss then those losses in export of trading goods have to be adjusted. They cannot be ignored. We, therefore, hold that a plain reading of section 80HHC makes it clear that in arriving at the profits earned from export of both self manufactured goods and trading goods, the profits M/s. Matrix Laboratories Ltd.

========== and losses in both the trades have to be taken into consideration. If after such adjustments there is a positive profit, the assessee would be entitled to deduction u/s 80HHC(1). If there a loss, he will not be entitled to any deduction."

21.Thus, what is to be adjusted against export profit is loss from another export. If in current year, only the losses from trading in export has to be adjusted against profits from another export (i.e. manufacturing activity) as per IPCA Laboratories Ltd. 's case (supra), it follows that only brought forward losses from export activity alone can be adjusted against export profits in the current year. Section 80HHC refers to computation of profits from export activity only. Therefore, non-export losses whether of current year or of earlier year's brought forward one, cannot be considered. Section 72 also provides that brought forward losses of the business will be treated as current year's loss for the purposes of set off against current year's income from the same business. This will also be consistent with section 80HHC 3© which provides for computation of "profits derived from such export". In working out profits derived from export one can only adjust losses from the export activity, whether of the current year or brought forward from earlier year. There is no scope to adjust non-export brought forwarded loss against export profits of current year u/s 80HHC.

23. In view of the above, we hold that brought forward loss from export activities alone can be set off against export profits of the current year. The Assessing Officer is directed to compute deduction u/s 80HHC accordingly."

25. According to AR, the lower authorities without considering the assessee's arguments for reducing only pro-rata brought forward losses, simply relied on the decision of ITAT, Pune in Thermax Surface Coatings Ltd. V JCIT (1041TD 199){2006). It is submitted that the Pune bench did not go into the merits of the decision of Mumbai bench of ITAT in the case of SKF Bearings Ltd (supra). H is submitted that the Mumbai bench of ITAT in SKF Bearings Ltd., case has discussed all the aspects of M/s. Matrix Laboratories Ltd.

========== IPCA Labs case and distinguished the Supreme Court decision from the claim of the assessee in SKF Bearings case. After a detailed review of Mumbai HC judgment in the case of Shirke as well as the Supreme Court decision in the IPCA case, the bench by relying on the provisions of sec. 80AB held that only pro-rata export losses and not the entire brought forward losses should be deducted while working out the benefit under sec. 80HHC.

26. The AR submitted that for the purpose of computing eligible export profits under sec. 80HHC read with sec. 80AB, the 'profits of the business' under clause (baa) should be reduced not by the entire amount of brought forward loss / depreciation of the earlier years but only that portion of the brought forward loss / depreciation as can be attributed to the export activity of the preceding relevant assessment year. Otherwise, the assessee submits that brought forward losses/ allowances relating to the domestic activity would also be reduced from the export profits of the year which is not the intent of the legislature.

27. It is the submission of the AR that Assessing Officer shall directed to allow the appellants claim of prorata reduction of brought forward losses and allowances.

28. The learned DR relied on the judgement of Supreme Court in the case of IPCA Laboratories Ltd. (266 ITR 521) (SC) and also on the order of the Tribunal in the case of Thermax Surface Coatings Ltd. V JCIT (104 ITD 199).

29. We have heard both the parties and perused the material available on record. This ground doesn't required adjudication as we have already held in earlier paras that the reopening is bad in law in these assessment years. Being so, we refrain ourselves from adjudicating this issue.

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30. The next alternate ground in ITA No. 939/Hyd/2010 is as follows:

> "Alternative to Ground No. 3, the Commissioner erred in confirming the action of the Assessing Officer in reducing the entire brought forward losses/ unabsorbed depreciation allowance of amalgamating companies eligible for set off under sec. 72A while computing relief u/s 80HHC."

31. The learned AR submitted that this appeal of the assessee is against the second reassessment after completion of the first re-assessment. The second notice u/s 148 was issued on 18/03/08 i.e., after expiry of 4 years from the end of the relevant assessment year. The reasons for re-opening are to reduce the entire brought forward losses while computing deduction u/s 80HHC under MAT provisions. Here also, the Assessing Officer is not having any fresh tangible material and it is simply a mere change of opinion. A reference to main computation at page 14 of the assessment order dt 31/03/05 u/s 143 r.w.s 147 (i.e., first reassessment) as well as the deduction u/s 80HHC computation at page 17 of the said order would reveal that the Assessing Officer who completed the first re-assessment proceedings agreed with the contention of the assessee that for computing deduction u/s 80HHC merely the brought forward depreciation u/s 32(2) need to be reduced and not the brought forward business losses. However, the Assessing Officer on a change of opinion issued 2nd notice u/s 148 without any fresh tangible material that too after expiry of 04 years from the end of the relevant assessment year. This is not valid.

32. He submitted that since the order of the CIT on this issue is against the ratio laid down by the Apex Court in the case of Kelvinator of India Ltd, (320 ITR 561), it is prayed to allow M/s. Matrix Laboratories Ltd.

========== ground No. 2 holding that the proceedings initiated on 18/03/2008 for the assessment year 2002-03 i.e., after the expiring of 4 years are invalid and the order dated 29/08/2008 passed u/s 143(3) r.w.s. 147 of the Act may be annulled. It is further submitted that all facts relating to respective dates are before the Appellate Tribunal and CIT has already examined this issue and gave his decision which as submitted earlier is against the law laid down by the Supreme Court.

33. The assessee submitted that as per clause (baa) of the Explanation to sec. 80HHC the term 'profits of the business' would mean the profits of the business as computed under the head 'profits and gains of business or profession'. It is to be noted that in terms of sec. 14 of the Act, all the income chargeable to tax has to be classified under 5 heads of income namely, A-Salaries, C-Income from house property, D-Profits and gains of business or profession, E-Capital gains and F- Income from other sources. Chapter IV of the Act under 'o' provided the methodology for computing 'Profits and gains of business or profession' which includes sections 28 to 44DA. Sec. 72A stipulates that brought forward depreciation and business loss of amalgamating companies are deemed to be the brought forward depreciation and business loss of amalgamated company (the appellant) in the year of amalgamation (The appointed date of amalgamation is 1 st Jan 2004). Section 32(2) deems the brought forward depreciation to be a part of current depreciation. Accordingly, for the purposes of arriving at the eligible profits as per the statutory definition given in clause (baa) of Explanation to sec. 80HHC, it is only the brought forward depreciation which should be deducted from the profits and gains of business for computing the export relief and the amount of brought forward business loss covered by section 72 read with section 72A should not be reduced for arriving at M/s. Matrix Laboratories Ltd.

========== profits and gains of business both for purposes of classifying under sec. 14 as well as for clause (baa) of sec. 80HHC.

34. He submitted that the CIT (A) at paragraph 7.1 of his order merely referred to the order of his predecessor in the subsequent Assessment year (AY 2004-05) and decided against the Assessee. He has not considered the legal proposition put up by the Assessee before him. Accordingly the Assessee pleaded to allow ground 4 in ITA No. 939/Hyd/10.

35. The DR relied on the order of the CIT(A).

36. We have heard both the parties and perused the material available on record. This ground doesn't required adjudication as we have already held in earlier paras that the reopening is bad in law in these assessment years. Being so, we refrain ourselves from adjudicating this issue.

37. In the result, assessee's appeal in ITA No. 835/Hyd/2005, 836/Hyd/2005 & 837/Hyd/2005 are partly allowed and 938/Hyd/2010 & 939/Hyd/2010 are allowed.

38. Now we will take up departmental appeal in ITA No. 930/Hyd/2005, 931/Hyd/2005, 932/Hyd/2005, 895/Hyd/ 2005 & 896/Hyd/2005 for adjudication.

39. The departmental appeals in ITA No.895/Hyd/2005 & 896/Hyd/2005 for the assessment year 2002-03 & 2003-04 are dismissed as infructuous as we have held in assessee appeals in bad in law and cancel the assessments itself. Being so, ITA No. 895/Hyd/2005 & 896/Hyd/2005 are dismissed as infructuous.

40. The common grounds in I.T.A. Nos. 930, 931 & 932/Hyd/2005 (Departmental appeals) are as follows:

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========== 3(a) The learned CIT(A) erred in holding that the interest income of Rs. 18,46,700 (A.Y. 2001-02), Rs. 23,85,326 (A.Y. 2002-03) and Rs. 38,90,000 (A.Y. 2003-04) is part of business profits assessable u/s 28 to 44.

3(b) The learned CIT(A) ought to have followed the decision of the Supreme Court in the case of Pandian Chemicals (262 ITR 278) for the purpose of deciding the head of income under which the interest income is assessable.

3(c) The learned CIT(A) ought to have held that the interest income earned on margin money was a receipt of the nature mentioned in Explanation (baa) to section 80HHC.

41. The learned AR submitted that for assessment years 2001-02, 2002-03 and 2003-04, the assessments were re- opened to re-compute export profits under clause (iv) of Explanation to Section 115JB by adopting profits of the business under clause (baa) of Section 80HHC in place of book profits. After re-opening the assessment, the Assessing Officer has made some. other additions and disallowances which have come to his knowledge in the course of re-assessment proceedings. The action of the Assessing Officer in computing deduction under clause (iv) of Explanation to Section 115JB by adopting the profits of business under clause (baa of section 80HHC is no longer correct as held by the Hon'ble Supreme Court in the case of Ajantha Pharma Pvt. Ltd vs CIT (327 ITR

305). This decision of the Apex Court was followed by the first appellate authority and re-computation worked out by the Assessing Officer was held as invalid by the first appellate authority. Hence, it has now become final that the reasons for re-opening the assessment no longer survive. In such circumstance, it is humbly submitted that the other additions and disallowances made by the Assessing Officer in the case of re-assessment proceedings do not survive equally.

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42. He invited our attention to the decision of the Delhi High Court in the case of Ranbaxy Laboratories Limited vs. CIT (336 ITR 136), wherein it was held that the Assessing Officer was not justified when the reasons for initiation of the proceedings ceased to survive. Similar view was taken by the Bombay High Court in the case of CIT vs. Jet Airways (331 ITR 236) (Bom). As held by the Bombay High Court in the case of Rallis India Ltd Vs ACIT (323 ITR 54 Bombay) it is well settled that, law as laid down by the Supreme Court is declaratory of the position as it always stood. Decision of Supreme Court in the case of Ajanta Pharma P Ltd (Supra) is a position deemed as it always was. Hence, the main reason to reopen i.e., reworking deduction u/s 80HHC r.w.s 115JB is not permissible at any time and therefore the other issues in the re assessment proceedings automatically fail and cannot survive.

43. Placing reliance on the above three decisions, it was submitted by the AR that since the very reason for re-opening the assessment ceases to survive, the other additions and disallowances made are not justified and may be cancelled.

44. The learned DR relied on the order of the Assessing Officer.

45. We have heard both the parties and perused the material on record. The deposit made by the assessee in the bank and interest earned on it cannot be considered as income from business much less income from export earning, it cannot be considered as income from export earnings, as there is no nexus between export business and interest income. Interest income was earned from the deposits made by the assessee with the bank and not from export business. Placing reliance on the judgement of Madras High Court in the case of Dollar Apparels M/s. Matrix Laboratories Ltd.

========== vs. ITO, 294 ITR 484 wherein placing reliance on the judgement of the same High Court in the cases of CIT vs. A.S. Nizar Ahmed & Co. (259 ITR 244) (Mad), K. S. Subbaiah Pillai & Co. India Pvt. Ltd. (260 ITR 304) (Mad) it was held that interest income cannot be considered as income from business. In view of the above judgements we are inclined to hold that interest income cannot be considered as business profit of the assessee u/s. 28 to 44 of the IT Act. This ground in Revenue appeals is allowed.

46. The next common ground in Revenue appeals in ITA Nos. 930 & 931/Hyd/05 is as under:

> "The learned CIT(A) erred in holding that conversion charges of Rs. 7,10,63,870 (A.Y. 2001-02) Rs. 1,70,88,345 (A.Y. 2002-03) were part of eligible profits for computing deduction u/s 80HHC as well as export profits under clause (iv) of Explanation to sec. 115JB."

47. The learned AR submitted that this issue does not survive in view of the notice u/s. 148 being bad in law. Without prejudice, he submitted that the assessee has earned conversion charges for A.Ys. 2001-02 and 2002-03 at Rs. 7,10,63,870 and Rs. 1,70,88,345, respectively. The conversion income is earned by carrying out third party job work at its manufacturing blocks. It used the same equipment and personnel for earning this income. The company's main objects include manufacture and sale of bulk drug as well as carry out conversion works. The difference between normal manufacturing activity and conversion job work is that in the latter case, the third party supplies raw materials. The AO objected to the inclusion of these receipts as part of eligible profits on the ground that conversion is an incidental activity and being seasonal has no relevance to the export activities of the assessee. The learned CIT (A) called for the Main objects of the Memorandum of Association of the assessee company and M/s. Matrix Laboratories Ltd.

========== found that they inter alia included manufacture of bulk drugs on behalf of others. He stated in his order that after examining the issue he found that plant and machinery used for the conversion business is the same as used for other business and the same skills are involved. On this basis he directed the AO to include the conversion income without deducting 90% thereof from the profits of business under clause (baa) of sec. 80HHC. The

department not being satisfied with this, is before the Tribunal.

48. The Assessee relied on the decision of Bombay High Court in CIT v Bangalore Clothing (2003)(260 ITR 371) as well as the decision of Hyderabad bench of ITAT in ACIT v Biotech Medical (2009)(119 ITD 143). The Assessee also relied on the decision of Karnataka High Court in the case of CIT v Mittal Creations (2011)(13 taxmann.com 237) rendered on 12-04-2011 with similar facts and in relation to deduction under sec. 80HHC. The OR on the contrary relied on the apex Court judgment in Ravindranathan (2007) (295 ITR 228) which declared that receipts constituting independent income having no nexus with exports to be reduced from business profits under clause (baa) for computation of export profits. The ITAT decision in Biotech Medical is rendered in the context of sec. 80lB which stands on a different footing and therefore clearly distinguishable. Though Bangalore Clothing and Mittal Creations are rendered in the context of sec. 80HHC, Bombay High Court in the recent case of CIT v Dresser Rand India Pvt. Ltd. (2010)(323 ITR 429) held that the decision in Bangalore Clothing to the extent to which it lays down a principle of law at variance with the subsequent judgement of the Supreme Court in Ravindranathan Nair's case would not therefore hold the field after the judgment of the Supreme Court.

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49. Alternatively, the AR pleaded that the conversion charges that should be deducted from the profits of the business in terms of clause (baa) should be net conversion income after reducing all expenditure incurred for the purposes of earning the said conversion income and not gross conversion receipts. In this connection, the Assessee once again canvasses support from the very recent decision of the Hon'ble Supreme Court in the case 'of ACG Associated Capsules Pvt. Ltd. v CIT in Civil Appeal No. 1914 of 2012 rendered on 8-02-2012 wherein the Court clarified that for the purposes of clause (baa) what is to be deducted from the profits of the business is, 90% of the receipts by way of brokerage, commission, interest, rent, charges or any other receipt of a similar nature included in such profits computed under the head profits and gains of business of an could be deducted under clause (1) of Explanation (baa) and not 90% of the quantum of any of the aforesaid receipts which are allowed as expenses and therefore not included in the profits of business of the assessee. In other words, the apex Court held that 90% deduction should be made from the net income of any of the receipts mentioned in clause (baa) and not the gross receipts.

50. It is not in dispute that the conversion charges are included in the profits of the business of the assessee. Therefore 90% of the said receipts are to be deducted for computing the export profits. But the, Assessee submits that such exclusion should be only to the extent of 90% of the net receipts viz., after deducting all expenditure in relation to earning that income.

51. It is therefore pleaded that while allowing the ground No. 4 of the department in ITA No. 930/05 & 931/05, the Assessee may be allowed relief by directing that only the net conversion charges be deducted from the profits of business for the M/s. Matrix Laboratories Ltd.

========== purposes of clause (baa) and not the gross conversion charges received. Since the extent of expenditure incurred on the earning of conversion charges has not been quantified the assessee pleads for reverting the matter to the AO for quantifying the extent of 90% of the net conversion income that should be reduced from the eligible profits for computing 80HHC in terms of clause (baa).

52. We have heard both the parties and perused the material available on record. This issue is covered by the judgement of Supreme Court in the case of Ravindranathan Nair (295 ITR

228) wherein the Apex Court held as under:

> In section 80HHC of the Income-tax Act, 1961, as originally inserted in 1983, the marginal note said "deduction in respect of export turnover". The marginal note was later changed to "Deduction in respect of profits retained for export business". Therefore, the very basis of the exemption under section 80HHC shifted from "export turnover" to "retention of profits for export business".
>
> Under the law as it stood during the assessment year 1993-94, section 80HHC(3) constituted a code by itself. Subsequent amendments have imposed restrictions/qualifications by which section 80HHC(3) has ceased to be a code by itself.
>
> The formula in section 80HHC(3) provided for a fraction of export turnover divided by the total turnover to be applied to business profits calculated after deducting 90 per cent. of the sums mentioned in clause (baa) of the Explanation. Profit incentives like rent, commission, brokerage charges, etc., though they formed part of the gross total income, had to be excluded as they were "independent incomes" which had no element of export turnover. All the four variables in the section were required to be kept in mind. If all the four variables are kept in mind, it becomes clear that every receipt is not income and every income would not necessarily include the element of export turnover.
>
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>
> ========== Clause (baa) of the Explanation states that 90 per cent. of the incentive profits or receipts by way of brokerage, commission, interest, rent charges or any other receipt of like nature included in business profits have to be deducted from business profits computed in terms of sections 28 to 44D. In other words, receipts constituting independent income having no nexus with exports were required to be deducted 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 the gross total income being business profits. But for the purpose of working out the formula and in order to avoid distortion in arriving at the export profits clause (baa) stood inserted to say that although incentive profits and

> "independent incomes" constituted part of the gross total income, they had to be excluded from gross total income because such receipts had no nexus with the export turnover.
>
> Processing charges, which are part of gross total income, form an item of independent income like rent, commission, brokerage, etc., and, therefore, 90 per cent. of the processing charges has also to be reduced from the gross total income to arrive at the business profits and, therefore, it has also to be included in the total turnover in the formula for arriving at the business profits in terms of clause (baa) of the Explanation to section 80HHC(3).

While arriving at the export profits under section 80HHC(3) as it stood in the assessment year 1993-94 processing charges are to be included in the total turnover.

Decision of the Kerala High Court in CIT v. K. Rajendranathan Nair [2004] 265 ITR 35 reversed.

Held,_also, that in arriving at the profit earned from export of self-manufactured goods and trading goods, the profits and losses in both trades have to be taken into consideration. If after the adjustment there was a positive profit, the assessee would be entitled to the deduction under section 80HHC(1). If there was a loss the assessee would not be entitled to any deduction."

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53. In view of the above judgement of Supreme Court, 90% of conversion charges has to be reduced from the gross total income to arrive at the business profit and it has to be included in the total turnover in the formula of arriving at the business profit in terms of clause (baa) of the Explanation to section 80HHC(3) of the Act. Accordingly, the Assessing Officer is directed to recompute the deduction u/s. 80HHC of the Act in the light of the judgement of Supreme Court cited supra. This ground of the Revenue is partly allowed.

54. The next ground in ITA Nos. 930, 931 & 932/Hyd/2005 is that the CIT(A) erred in directing to delete sales tax and excise duty from the total turnover for computing deduction u/s. 80HHC of the Act.

55. This issue is covered in favour of the assessee by the judgement of Supreme Court in the case of CIT vs. Lakshmi Machine Works (290 ITR 667) wherein the Apex Court held as under:

> "Section 80HHC of the Income-tax Act, 1961, is a beneficial section: it was intended to provide incentive to promote exports. The intention was to exempt profits relatable to exports. Just as commission received by the assessee is relatable to exports and yet it cannot form part of "turnover" for the purposes of section 80HHC, excise duty and sales tax also cannot form part of "turnover". Just as interest,

commission, etc., do not emanate from the "turnover" so also excise duty and sales tax do not emanate from such turnover. Since excise duty and sales tax did not involve any such turnover such taxes had to be excluded. Commission, interest, rent, etc., do yield profits, but they do not partake of the character of turnover and therefore they are not includible in the "total turnover". If so, excise duty and sales tax also cannot form part of the "total turnover" under section 80HHC(3).

One cannot interpret the words "total turnover" with reference to the definition of the word "turnover" in M/s. Matrix Laboratories Ltd.

========== other laws like the Central sales tax or as defined in accounting principles.

Excise duty and sales tax are indirect taxes. They are recovered by the assessee on behalf of the Government.

By the Court : The principal reason for enacting a formula in section 80HHC of the Income-tax Act, 1961, is to disallow a part of the concession thereunder when the entire deduction claimed cannot be regarded as relating to exports. Therefore, while interpreting the words "total turnover" in the formula in section 80HHC one has to give a schematic interpretation. The various amendments made therein show that receipts by way of brokerage, commission, interest, rent, etc., do not form part of business profits as they have no nexus with the activity of export. The amendments made from time to time indicate that they became necessary in order to make the formula workable. If so, excise duty and sales tax also cannot form part of the "total turnover"

under section 80HHC(3) : otherwise the formula becomes unworkable.

Decisions of the Madras High Court in CIT v.

Sundaram Clayton Ltd. [2006] 281 ITR 425 (Mad) and CIT v. Sri Jayajothi and Co. Ltd. [2007] 290 ITR 660 (Mad) affirmed.

[The Supreme Court made it clear that the reasoning in this case is confined to the workability of the formula in section 80HHC as it stood in the assessment year 1993-94.]

56. This ground in Revenue appeals is dismissed.

57. The next ground in ITA Nos. 931 and 932/Hyd/05 is as follows:

"6. The learned CIT(A) erred in allowing the interest claim for Rs. 26,47,050 (A.Y. 2002-03) and Rs. 35,28,126 (A.Y. 2003-04) by holding that interest relatable to an acquisition of capital asset would also be a permissible deduction u/s 36(1)(iii)."

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58. The learned AR narrated the facts that the Assessing Officer rejected the claim of the assessee in respect of interest expended for acquisition of the capital asset for the purpose of the business on the ground that interest incurred prior to commission of the asset is to be capitalised in terms of Explanation (8) to section 43(1) of the Act. The amount claimed by the assessee for the assessment year 2002-03 at Rs. 26,47,050 and for the assessment year 2003-04, Rs. 35,28,126. The CIT(A) allowed the claim of the assessee placing reliance on the judgement of Supreme Court in the case of DCIT vs. Core Health Care Ltd., 298 ITR 194 (SC).

59. We have heard both the parties and perused the material on record. This issue is covered in favour of the assessee by the judgement of Supreme Court in the case of DCIT vs. Core Health Care Ltd. (298 ITR 194) wherein the Apex Court held as under:

> "Section 36(1)(iii) of the Income-tax Act, 1961, has to be read on its own terms : it is a code by itself. It makes no distinction between money borrowed to acquire a capital asset or a revenue asset. All that the section requires is that the assessee must borrow capital and the purpose of the borrowing must be for business which is carried on by the assessee in the year of account. Unlike section 37 which expressly excludes an expense of a capital nature, section 36(1)(iii) emphasises the user of the capital and not the user of the asset which comes into existence as a result of the borrowed capital. The Legislature has, therefore, made no distinction in section 36(1)(iii) between "capital borrowed for a revenue purpose"

and "capital borrowed for a capital purpose". An assessee is entitled to claim interest paid on borrowed capital provided that the capital is used for business purpose irrespective of what may be the result of using the capital which the assessee has borrowed. "Actual cost" of an asset has no relevancy in relation to section 36(1)(iii).

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========== The proviso inserted in section 36(1)(iii) by the Finance Act, 2003, with effect from April 1, 2004, will operate prospectively.

Held, accordingly, that the assessee was entitled to deduction under section 36(1)(iii) prior to its amendment by the Finance Act, 2003, in relation to money borrowed for purchase of machinery even though the assessee had not used the machinery in the year of borrowing.

Decision of the Gujarat High Court in Deputy CIT v. Core Healthcare Ltd. [2001] 251 ITR 61 affirmed on this point.

Held, also, remanding the matters to the High Court, that the questions : (a) whether advertisement expenses incurred by the assessee to create a brand image with enduring benefit are allowable as revenue expenditure, (b) whether the Tribunal had erred in granting deduction under section 35D regarding short-term loan, in view of the Explanation to section 35D(3) which refers only to long-term borrowings, and (c) whether the Tribunal had erred in directing deduction under sections 80HH and 80-I on the miscellaneous income of Rs. 26,64,113 being income on sale of empty containers, were substantial questions of law and the High Court erred in dismissing the application of the Department on those questions and the High Court had to decide them."

60. In view of the above judgement of Supreme Court we are inclined to decide the issue in favour of the assessee and against the Revenue. This ground of the Revenue is rejected.

61. The next ground in ITA Nos. 931 & 932/Hyd/2005 is that the learned CIT(A) ought to have held that the provisions for unascertained liabilities i.e., provision for diminution in value of investments, provision for gratuity, provision for leave encashment and provision for Rs. 63,36,246 (A.Y. 2002-03) and Rs. 1,75,88,677 (A.Y. 2003-04) attracted the provisions of clause (c) of Explanation to sec. 115JB(2) of the Act.

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62. The learned AR submitted that this ground automatically fails in view of the reopening of assessments being bad in law. In addition to this, he also submitted that the Assessing officer disallowed the following amounts in each of A.Y. 2002-03 & 2003-04 while computing book profits for the purposes of levy of book profit tax under sec. 115JB:

S. No.	Item	Asst. Year 2002-03	Asst. Year 2003-04
1	Provision for bad and doubtful debts		20,08,352
2	Provision for gratuity	32,66,350	60,86,994
3	Provision for leave encashment	10,50,840	44,61,584
4	Provision for bonus	18,76,556	50,31,747
5	Provision for diminution in value of investment	1,42,500	
	TOTAL	63,36,246	1,75,88,677

63. The assessee debited the above amounts in its profit and loss account prepared in accordance with Part 11 and Part III of Schedule VI to the Companies Act, 1956. The provision for bonus is made under the payment of bonus Act, while the gratuity and leave encashment liabilities are created on

the basis of actuarial valuation as certified by an independent person. Provision for doubtful debts and value of investment are specific to certain items and under no stretch could be called to be unascertained. The AO did not dispute any of this but contended that the above amounts fall under clause © of the Explanation to sec. 115JB. He distinguished the decision rendered by Bombay High Court in the case of CIT v Echjay Forgings P Ltd (2001)(251 ITR 15). The CIT (A) directed allowance of the above mounts by following the decision of Bombay High Court. As regards Leave encashment the CIT(A) declared that since it is made pursuant to the Accounting Standard - 15 and quantified on the basis of actuarial science there argument that it is not ascertained is therefore not M/s. Matrix Laboratories Ltd.

========== correct. Provision for doubtful debts and diminution in value of investment are not in respect of liabilities but in respect of assets which cannot be roped in under clause (c) of Explanation.

64. The learned DR has argued that the Provision for doubtful debts of Rs. 20,08,3521 and Provision for diminution in value of investments of Rs. 142,5001- are hit by the retrospective amendment to sec. 115JB vide Finance (No.2)Act, 2009 whereby clause (i) is inserted with effect from 1-4-2001. Excepting this, the DR conceded that the claim is squarely covered by the decision of Bombay High Court in CIT v Echjay Forgings P Ltd. (2001)(251 ITR 15).

65. The Bombay High Court's decision is rendered under sec. 115J but it has equal force for the purposes of sec. 115JB as both are pari materia. The Court allowed deduction of provision for bonus, gratuity and doubtful debts for computing book profits. Delhi High Court in CIT v ILPEA Paramount (P.) Ltd., (2010) (192 Taxman 65) has permitted deduction of gratuity liability for computing the book profits. The co-ordinate Visakhapatnam bench of ITA T in Eastern Power Distribution Co. Ltd. v ACIT (2011)(10 taxmann.com 282) rendered on 14-3- 2011 has held that gratuity and leave encashment are ascertained liabilities. The Assessee therefore pleads for dismissing the department grounds at No 5 in ITA No. 931/05 and at No. 6 in ITA No. 932/05 and confirming the CIT (A) order except to the extent of provision for doubtful debts of Rs. 20,08,352/- and diminution in investments Rs. 1,42,500/-.

66. We have heard both the parties and perused the material on record. In view of the retrospective amendment vide Finance Act, 2009 wherein there is an insertion of clause (i) with M/s. Matrix Laboratories Ltd.

========== retrospective amendment from 1.4.2001 wherein the amount or amounts set aside as provision for diminution in the value of revenue assets has to be added to the book profit. In view of this, this issue is decided against the assessee. The ground raised by the Revenue is allowed.

67. The next ground in ITA Nos. 931 & 932/Hyd/2005 is that the learned CIT(A) erred in holding that the DEPB benefits of Rs. 71,47,521 (A.Y. 2002-03) and Rs. 96,90,979 (A.Y. 2003-

04) accrued to the assessee could not be deducted for computing export profits both u/s 80HHC and clause (iv) of Explanation to sec. 115JB.

68. The learned AR submitted that the Assessee engaged in the business of manufacture and sale of bulk drugs has made exports of its products and consequent to the same entitled to DEPB (Duty Entitlement Pass Book) benefits under Foreign Trade Policy. The entitlement for A.Y. 2002-03 is Rs. 71,47,521 and for A.Y. 2003-04 is Rs. 96,90,979. The AO noted that the DEPB benefits accrue on export of specific bulk drugs and a certificate is issued which can either be sold in the market to other exporters or can be utilized by the company for its own imports. In the latter case, the customs duty to the extent of DEPB certificate would be reduced. The AO also noted that the amount of benefit so availed for imports is credited to raw materials account. The AO rejected the assessee's contention that the benefit is an abatement in the cost of goods and should therefore form part of profits of the business for the purposes of deduction under sec. 80HHC. AO stated that the DEPB benefit comes under the purview of clause (iiib) of sec. 28 and therefore 90% thereof has to be excluded for the purposes of clause (baa) because whether the DEPB benefits are sold or utilized for self the characteristic of the receipt of the nature of an assistance as M/s. Matrix Laboratories Ltd.

========== per clause (iiib) of sec. 28 remains. The CIT(A) allowed the claim of the Assessee by relying on the decision of Delhi Tribunal in P&G Enterprises P Ltd v DCIT (93 TTJ 150).

69. The Hon'ble Supreme Court recently in the case of Topman Exports v CIT (Civil Appeal No. 1699 of 2012) rendered on 8-02-2012 while overturning the decision of Bombay High Court I CIT v Kalpataru Colours and Chemicals (ITA(L) 2887 of 2009) adjudicated upon the nature of DEPB benefits. In paragraph 12 of the judgment the apex Court held that DEPB is a kind of assistance given by the Govt., of India to an exporter to pay customs duty on its imports and it is receivable once exports are made and an application is made by the exporter for DEPB. The Court therefore held that DEPB is 'cash assistance' and falls under clause (iiib) of sec. 28 even before it is transferred by the assessee. In this case, the Court was required to opine whether the face value and the profit realized from sale of DEPB is to be assessed in the year of transfer under clause (iiid) which would deprive an exporter with over Rs. 10 crore turnover from claiming pro-rata deduction in respect of such benefits under Third Proviso under sub-section (3) of sec. 80HHC, unless he fulfils certain conditions specified therein. After examining the issue in detail, the Court while agreeing with the view of the Special bench of the Mumbai Tribunal in Topman Exports v ITO (318 ITR 87) (AT)) held that the face value would be assessable under 28(iiib) and the profit under 28(iiid) and in case the exporter (having export turnover in excess of Rs 10 crores) is unable to fulfil the conditions specified in Third Proviso it is only the profits earned on the sale of DEPB that would be deprived of higher pro-rata deduction. The Court held that the DEPB benefits to the extent of face value should be allowed to the Assessee in terms of First Proviso under sub-

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========== section (3) without applying the conditions stipulated in Third Proviso.

70. It is submitted that while at the first instance, 90% of the value of DEPB benefits would be reduced from the profits of the business in terms of sub-clause (1) of clause (baa) the benefit under sec. 80HHC would once again be restored back to the Assessee in terms of the First Proviso under sub-section (3) of sec. 80HHC to the extent of the 90% value of such benefits as a proportion of export turnover/total turnover. Since DEPB is self- utilized by the Assessee the enhancement of deduction under sec. 80HHC under First Proviso of sub-section (3) should be made without any recourse to the rigors of conditions stipulated under Third Proviso.

71. The AR submitted that the matter may be restored to the file of the Assessing officer to compute with respect to DEPB benefits, the deduction that is allowable under First Proviso of sub-sec (3) and enhance the claim u/s. 80HHC.

72. We have heard both the parties and perused the material on record. In our opinion this issue is covered in favour of the assessee by the judgement of the Supreme Court in the case of Topman Export (supra) wherein they have confirmed the order of the Tribunal in the case of Topman Exports vs. ITO (318 ITR

87) wherein the Apex Court held that the face value would be assessable under 28(iiib) and the profit under 28(iiid) and in case the exporter (having export turnover in excess of Rs. 10 crores) is unable to fulfil the conditions specified in Third Proviso it is only the profits earned on the sale of DEPB benefits to the extent of face value should be allowed to the assessee in terms of First proviso under subsection (3) without applying the M/s. Matrix Laboratories Ltd.

========== conditions stipulated in Third Proviso. This issue is decided in favour of the assessee. Revenue ground is dismissed.

73. The next ground in ITA No. 932/Hyd/2005 is that the learned CIT(A) erred in holding the disallowance of depreciation of Rs. 10,40,050 on the demolished assets dehorse the provisions of section 32(1) r.w.s. 43(6)(c)(i)(B) of the Act.

74. The learned AR submitted that the assessee, during the year, demolished certain assets at its manufacturing unit but did not reduce the written down value of these assets from the block of assets because it could not ascertain 'moneys payable' in respect of these assets. The Assessee contended that in terms of sub-clause (i)(B) of clause (c) of sec. 43(6) the block of assets is required to be reduced only by the amount of 'moneys payable' in respect of assets sold or discarded or demolished or destroyed during the previous year together with scrap value, if any. The Assessing Officer rejected the claim on the ground that even in a situation of 'block of assets', the depreciation is permissible only if the twin conditions of ownership and actual user is satisfied. He, therefore, reduced the entire written down value of such demolished assets from the relevant 'block of assets'. The amount so reduced by him under the respective blocks is as under:

Buildings	Rs. 48,38,792
Electrical installations	Rs. 21,96,683
Plant & Machinery	Rs. 28,097

75. By such an adjustment he reduced the depreciation claim of the assessee by Rs. 10,40,050. On appeal, the CIT(A) directed the Assessing Officer to allow the depreciation and for this purpose he relied on the jurisdictional Tribunal's decision in the case of Natco Exports v DCIT (2003) (86 ITD 445) (Hyderabad).

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76. The learned DR argued against the relief allowed by the CIT(A) and relied on Delhi Tribunal's decision in Gaurav Khullar v ACIT(2007) (110 TTJ 914) as well as the Chennai Tribunal decision in the case of Rane Brake Lining Ltd v JCIT (2007) (107 TTJ 475). The Assessee submits that in both these cases cited by the DR, there is a transfer of asset for a consideration but the said sale price has not been reduced by those assessees for the purposes of computing the written down value of the 'block of assets'. It is submitted that these cases are clearly distinguishable on facts. In the case of the present assessee, there is no transfer of assets. The assets of the assessee are merely demolished. Consequently the assessee is unable to quantify / determine the sum of 'moneys payable' with regard to assets discarded or demolished or destroyed in terms of the stipulations laid down in sub-clause (i)(B) of clause (c) of sec. 43(6).

77. On the other hand, the assessee relied on the order of the CIT (A) and the decision of Hyderabad bench in Natco Exports v DCIT (2003) (86 ITD 445). In the latter case, the Assessee carrying on the business of farming and trading of shrimps constructed ponds for shrimp farming on leased lands and had incurred certain expenditure. For the assessment year 1996-97, the assessee had treated the cost of those ponds as 'plant' and claimed depreciation at the rate of 25 per cent which was allowed by the Assessing Officer. During the assessment year 1997-98, the assessee had given back the leased lands to the farmers and had, thus, discarded the ponds so constructed without any consideration. The assessee continued to claim depreciation on the ponds so surrendered even though it had written off the same in its books of account on the ground that the cost of those ponds formed part of block of assets of 'plant M/s. Matrix Laboratories Ltd.

========== and machinery' on which depreciation at the rate of 25 per cent had already been allowed and that the block of assets under the new concept continue especially in view of the fact that the block contained other assets as vehicle, machinery, etc.

78. The AR submitted that the Hyderabad Tribunal in the above case, after a detailed discussion held that in so far as discarded assets are concerned, the adjustment i.e. required to be made under the concept of "block of assets" for the purposes of allowing depreciation is to reduce the monies receivable consequent to such discarding from the block. In the case of the assessee, as no money whatsoever was payable to him on handing over the ponds constructed on leased land to the owners of land, there can be no amount whatsoever that can be reduced from the block of assets. Hence, the block continues at its written down value. Once an asset has been included in the block, it loses its individual identity and what is relevant is only the WDV of the block and nothing else. To be consistent with this view, the Assessee did not claim revenue loss for assets surrendered, nor

short-term capital loss under section 50(2). Accordingly it allowed the claim of the Assessee for depreciation in respect of discarded assets for which 'moneys payable' cannot be ascertained.

79. The AR submitted that since the cases cited by the DR are clearly distinguishable and the case' of the Assessee is on all fours with that of the case before the Hon'ble Hyderabad bench in Natco Exports, the Assessee pleads that the ground No. 2 of the Department in ITA No. 932/05 be dismissed and the order of the CIT(A) in this behalf be confirmed.

80. The learned DR relied on the order of the CIT(A) and also relied on the judgment of Calcutta High Court in the case of CIT M/s. Matrix Laboratories Ltd.

========== Vs. Oriental Coal Co. Ltd. (206 ITR 682) wherein held that the where the factory of the assessee remained closed throughout the previous year, the plant and machinery had not been actually used for the purpose of business, the depreciation u/s 32 of the Act was not allowable under such plant and machinery. Further, he relied on the judgment of the Bombay High court in the case of Hindustan Chemical Works Ltd. Vs. CIT (124 ITR 561) for the same proposition.

81. We have heard both the parties and perused the material on record. In our opinion, this issue is squarely covered in favour of the assessee by the order of co-ordinate Bench in the case of Natco Exports vs. DCIT (86 ITD 445) wherein held that insofar as discarded assets are concerned, the adjustment i.e. required to be made under the concept of "block of assets" for the purposes of allowing depreciation is to reduce the monies receivable consequent to such discarding from the block. In the case of the assessee, as no money whatsoever was payable to him on handing over the ponds constructed on leased land to the owners of land, there can be no amount whatsoever that can be reduced from the block of assets. Hence, the block continues at its written down value. Once an asset has been included in the block, it loses its individual identity and what is relevant is only the WDV of the block and nothing else. In view of the above order the Tribunal we are inclined to dismiss the ground taken by the Revenue.

82. The next ground in Revenue appeal in ITA No. 932/Hyd/2005 is that the learned CIT(A) has erred in deleting the addition of imported entitlements for Rs. 1,76,10,180 for A.Y. 2003-04 by holding that the real income is taxable in spite of the fact that the assessee company follows mercantile system of accounting and that the assessee has been consistently M/s. Matrix Laboratories Ltd.

========== admitting the imported entitlements as incomes till the A.Y. 2002-03.

83. The learned AR submitted that the assessee is engaged in the business of manufacture and sale of bulk drugs (Active Pharmaceutical Ingredients) and during the course of its business it exports its products out of India. For this purpose, it sometimes imports raw materials from outside India. The company is required to pay customs duty on its imports but in terms of the Foreign Trade Policy of the Govt., of India, the company can avail customs duty exemption under 'Advance License Scheme'

on inputs / raw materials imported from outside India which are utilized in manufacture of exported goods.

84. The AR submitted that the advance license scheme is applicable only in respect of raw materials used for specific goods exported. A company is not permitted to import raw materials for product 'b' when exports are of product 'a'. Internal swapping of raw material products is also not permitted. Similarly the entitlement cannot be traded in the market for money or money's worth. It is only an actual user license to import specified raw material inputs against the License. The entitlement lapses but cannot be traded or sold in the market for a profit. Under the Advance License Scheme, there is no duty draw back or cash assistance which the government will pay to the exporter. Unlike DEPB scheme, the license is also not tradable. The Advance License Scheme is an actual user scheme and would lapse if the imports are not availed.

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85. According to AR, under the Advance License Scheme the exports can precede the imports or vice versa. Under each of the two cases, the entitlement or obligation is as under:

> (a) If the entitlement is awarded against an export already made, the company should import before the License expires. In the interregnum period, several contingencies can arise, which in the end may result in not importing the specified input thus depriving the monetary value of the entitlement. For instance if, • the domestic prices for the specific input fall due to slump in demand, or • the international prices for the specific input exceed the domestic price, or • the Govt., trade policy may allow import at a lower duty, or • alternate supply sources can develop in India, or • the demand for end product can disappear, In all the above cases, there is no longer a need to import. The businessman would in the above cases, forego the right to import and instead maximize his returns by buying the raw materials locally or alternatively if there is no demand for the product, discontinue its manufacture. The entitlement therefore, is very transient and mayor may not crystallize. The certainness of the entitlement can be ascertained / crystallized only after the actual import of the concerned inputs. Till such time that the actual import is made, the benefit of the entitlement is only contingent and is in the realm of future. Since the benefit is dependent on the happening of an actual import which is totally dependent on the vagaries of business, the same is contingent and is not to be recognized.
>
> (b) In case, the License is obtained for import of inputs prior to actual export of product, there is no entitlement, but only an obligation to export which is fixed and if exports are not carried out within the given time, the company is required to make payment of customs duty M/s. Matrix Laboratories Ltd.

========== together with interest. Here too, the obligation has not crystallized until after the date for shipment of exports has expired. Till such time, the obligation is contingent and is dependent on the vagaries of business. Further under sec. 43B of the Act, customs duty provision is allowable only in the year of payment.

86. He submitted that since the entitlement and obligation is both contingent until after the actual import of inputs / export of goods, the company has decided not to recognize the same in its books from Asst. Year 2003-04 which practice has been consistently followed in the subsequent assessment years. This method does not disturb the profits of the Assessee because in the year of availing the entitlement by actual import of goods, the duty benefit would accrue which would increase the profit. Similarly if an obligation crystallizes for non-export of goods within the stipulated time, the duty payment would be accounted on cash basis under sec. 43B. Therefore, there is no distortion of profits. Consequently, it is submitted that the method followed by the Assessee in not accounting for contingent benefits and obligations is in line with the provisions of Income Tax Act, 1961 for charging real income to tax as against notional income. The income tax department has accepted the said treatment in all the subsequent years and there is no dispute in this regard.

87. The AR further submitted that under the Income Tax Act, what is taxed is a real income. If an income does not arise or a debt is not created in favour of the assessee, then no income can be recognized even under mercantile method of accounting. In the present case, no debt is created in favour of the company. Contrasting Advance License Scheme (as applicable to Assessee) with the DEPB scheme, it is submitted that in the latter, the Govt. issues a tradable paper which can be used across all M/s. Matrix Laboratories Ltd.

========== materials as well as traded for profit. The Assessee has no dispute with regard to DEPB benefits, which it has accrued in the books of account and offered to tax (Please refer to Annexure 12 - supra). What the assessee has now done in the relevant previous year is that it has decided to follow the real income basis and therefore, it has not recognized the import entitlements arising from Advance License Scheme. It is so, because the entitlements do not 'bestow any right on the Assessee as they are contingent and dependent on whether the Assessee imports the goods or not. Unlike DEPB, the entitlements are neither tradable nor enforceable (except in case of obligation). If there is no import, then the entitlement lapses and the benefit is not availed.

88. He submitted that the Advance License Scheme is not covered by any of the provisions of clause (iiia) (iiib) and (iiic) of Sec. 28 of the Act. Sec. 28(iiia) relates to profit on sale of a license. However, the license under Advance License Scheme is not saleable. Sec. 28(iiic) relates to duty drawback a duty remission scheme while the present issue relates to Advance License Scheme. In duty drawback, the exporter is refunded the duty it paid. On the contrary, in the Advance License Scheme there is no refund but a mere entitlement to import if it suits the business. Therefore, the provisions of Sec 28(iiia) and 28(iiic) are not applicable. Sec. 28(iiib) relates to cash assistance received or receivable by any person against exports. The license under Advance License Scheme does not entitle the company to receive any money or money's worth. It merely allows it to import goods duty free. It therefore, does not fall under Sec. 28(iiib) as cash assistance. The DEPB benefits which the

assessee receives under the Duty Remission Scheme are already accounted as benefits receivable in the books of account soon after the DEPB certificates are issued by the concerned M/s. Matrix Laboratories Ltd.

========== authority. In terms of Chapter 4 of the Foreign Trade Policy, while Advance License Scheme falls under Duty Exemption Scheme, the DEPB falls under Duty remission scheme. The DEPB benefits are tradable while the import entitlement under Advance License Scheme are user specific and do not permit any transfer or sale. In the recent case of Topman Exports v CIT, in Civil Appeal No. 1699 rendered on 8-02-2012, the Hon'ble Supreme Court has held that DEPB benefits are in the nature of Cash Assistance under 28(iiib). The Assessee has been following the system approved by Supreme Court in respect of its DEPB benefits. Since the entitlements under Advance License Scheme are not tradable / transferable and user specific and the availment is contingent upon actual import of the inputs and if there is no import, the entitlement evaporates. On these facts, the Assessee contends that there is no real income since no debt has been created in favour of the Assessee unlike a DEPB certificate.

89. The AR contended that the benefits cannot accrue under the scheme until the actual import of raw materials. If the same are accounted prior to that date, as the case in earlier periods, tax is not being levied on real income but on contingent income. As at the year end, the entitlements did not accrue to the Assessee since no debt is created in favour of the Assessee to treat the amount as income. Accrual in the legal sense occurs only when a right to receive the amount had arisen during the year. When such a right is not present, the amount has not accrued. Therefore, even under mercantile method of accounting the amount would not accrue for it to be taxed as income. In this connection, the Assessee relies on the decisions of Hon. Supreme Court in the cases of Godhra Electricity Co. Ltd. (1997) (225 ITR 746).

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90. The AR submitted that the apex Court in the later case held that the question whether there was accrual of income has to be considered by taking the probability or improbability of realization in a realistic manner. In this case, the assessee was an electricity supply company. It enhanced the rates of power by a certain date. The State govt. directed not to recover the enhanced rates for 6 months. Before the expiry of the said six months the consumer challenged the enhancement by filing a suit. Before the suit was decided the business was taken over by the Government. The Supreme Court held that no real income on account of enhancement of rates had accrued to the assessee. The entries in the books of accounts represented only hypothetical income and the impugned amounts as brought to tax by the Income-tax Officer did not represent the income which had really accrued to the assessee-company during the relevant previous years.

91. Further AR submitted that import entitlement does not create a debt in favour of the company. The company has no right to sue the government or any party for claiming the benefit. The benefit is merely a notional and hypothetical entry which crystallizes only if imports are made. Since on the

date of preparing the final accounts, such entitlements do not create any right in favour of the company, the resultant benefits being notional are ignored. The apex Court in United Commercial Bank v CIT (1999)(240 ITR 355) agreed that the concept of real income should be applied to determine whether income is real or not for the purposes of taxation and only tax real income. The Assessing officer did not dispute the fact that the entitlement is contingent. He merely alluded to the fact of exports having been made but did not appreciate the other limb i.e., whether the Assessee has imported the inputs during the previous year. Until the time the inputs are imported, the Assessee submits M/s. Matrix Laboratories Ltd.

========== that the entitlement is merely notional and on paper. The AO's contention that it has accrued on export is therefore, totally incorrect and far from the truth without appreciation of the Government's scheme in this regard. The AO has no where disputed that the License is only to the actual user and it is not tradable or inter-changeable.

92. According to AR, the Assessee continues to follow mercantile method of accounting in respect of accounting for import entitlements. What it has done merely is that as against the notional entries passed by it in its books, it has chosen to recognize the benefits only when they accrue. It submits that the entitlements accrue at the time of import of raw material and not earlier. Consequently, the import entitlements arising from Advance Licensing Scheme are accrued in the books of account on import of raw materials at the time of actual payment of duty. The Assessee submits that following the judicial pronouncements of the apex Court there is no accrual of income prior to actual import of these raw materials. The earlier accounting was notional and the same is sought to be changed. In the true sense, it is not a change in method of accounting but to bring in the correct and real profits to tax. Consequently, the Assessee did not include an estimated value of Rs.176,1 0,180 towards the import entitlements it is entitled under Advance License scheme, if imports are made in the subsequent years, as a receivable amount while finalizing the accounts for the year ended 31st March 2003. The Hon'ble CIT(A) has, after a detailed examination of the case, and after obtaining further information from the Assessee, held that the import entitlements are contingent and accrue only in the year of actual import of raw materials. He therefore held that even under mercantile system, no income can accrue until an enforceable claim / debt is created.

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93. The learned DR during the course of the hearing did not dispute the above facts. He merely contended that Advance license scheme is same as DEPB. He however, did not appreciate the differences between the two. The Assessee invites the kind attention of the bench to the fact that the OEPB is a tradable certificate and issued after the export which can be sold and money encashed by the exporter. But that is not the case with the Advance License scheme. Here the entitlement is after export but the benefit is secured only if the import is made. The Assessee submits that the benefit accrues only in the year of import and not earlier. So accounting the benefit on the basis of export is only addressing one limb and ignoring the other. Even under mercantile method the entitlement is to be accounted only on actual import and not before. Till such time the import takes place the

entitlement is only notional and contingent.

94. Without prejudice to our arguments that there is no change in the method of accounting but only a change to afford assessment of taxes on the true and real income, the AR submitted as follows:

> (a) The company has during the assessment year 2003-04 relevant to accounting year 2002-03 changed the method of accounting for import entitlements following the real income basis of accounting and consequently accounting the import entitlements only in the year of actual import of inputs for which lower customs tariff is applicable.

Similarly the obligation is accounted only in cases where customs duty is paid in terms of sec. 438 of the Act. This change accounting treatment has been mentioned in note no. 14 of schedule 3.01 relating to notes on accounts is M/s. Matrix Laboratories Ltd.

========== also referred to in tax audit report vide clause 11(b) & (c). The reason for change is due to fact that the import entitlements accrue only when the same is utilized for the procurement of the specified inputs. If the required inputs are not procured then such import entitlements cease to exist. It is to be noted that import entitlements is a contingent asset which can accrue only when the same is been utilized.

(b) It is submitted that an assessee is entitled to change the method of accounting provided the same is followed consistently and is bona fide. It is submitted that the Assessing Officer did not make any adverse finding in this behalf. The Assessee has consistently followed the revised basis with regard to accounting for entitlements under advance license scheme in the subsequent years in terms of the assessment record.

(c) The change is bona fide since the earlier system was inefficient and considered contingent benefits in respect of which the Assessee is unable to legally enforce the debt. The benefit would lapse if the import of raw materials does not take place. The reasons for not importing could be several like (a) phasing out of the end product due to change in demand (b) lower domestic prices (c) inferior quality (d) favourable terms of supply and credit. Since these are all relevant and important factors considered by a businessman at the time of actual import, the import entitlement, many a time remains unutilized and allowed to lapse. Consequently, the Assessee decided not to follow this basis for accounting of import entitlements under advance license and chose to account for the benefit only when actual imports are made as abatement in cost of M/s. Matrix Laboratories Ltd.

========== import duty. The present method recognizes the expense in the year of incurrence without notional entries. Hence this method is bona fide and follows the concept of real income, accruing amounts that are legally due to the Assessee.

95. The AR relied on the recent decision of Himachal Pradesh High Court in the case of CIT v HP State Civil Supplies Corporation Ltd (2009)(307 ITR 102) where in it permitted the change of stock valuation from FIFO method to Average cost method on the ground of practical difficulties faced. The Court said that there is no legal bar for change in the method of accounting and if any temporary dip results in taxable income consequent to the same, the same is made good in the subsequent years. The Court therefore accepted the change in method of accounting as bona fide.

96. The learned AR submitted that since the case relied upon by the DR is clearly distinguishable as being not relevant for the present issue, and the Assessee's case for assessment on real income is based on the Hon'ble Supreme Court's decisions, it is pleaded that the ground No. 3 of the Department in ITA No. 932/05 be dismissed and the order of the CIT(A) in this behalf be confirmed.

97. The learned DR relied on the order of the Assessing Officer.

98. We have heard both the parties and perused the material on record. We are agreeing with the findings of the CIT(A) that the import entitlements are contingent in nature and accrue only in the year of actual import of raw materials and real income to be taxed even though in book keeping, an entry is made about hypothetical income which doesn't materialize.

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========== This view ours fortified by the judgement of Supreme Court in the case of Godhra Electrical Co. Ltd. vs. CIT (225 ITR 746) (SC). Accordingly, we reject the ground taken by the revenue. This ground in ITA No. 932/Hyd/2005 is dismissed.

99. In the result assessee appeals in ITA No. 835, 836 & 837/Hyd/2005 are partly allowed, ITA Nos. 938 & 939/Hyd/2010 are allowed, Departmental appeals in ITA Nos. 895 & 896/Hyd/2005 are dismissed, 930/Hyd/2005 is partly allowed for statistical purpose, ITA No.931 & 932/Hyd/2005 are partly allowed Order pronounced in the open court on 2nd July, 2012.

Sd/-	Sd/-
(ASHA VIJAYARAGHAVAN)	(CHANDRA POOJARI)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Hyderabad, dated the 2nd July, 2012.

Copy forwarded to:

1. M/s. Matrix Laboratories Ltd., 1-1-151/1, IV Floor, Sairam Tower, Alexander Road, Secunderabad-3.

2. The Assistant Commissioner of Income-tax, Circle-2(2), Aayakar Bhavan, Hyderabad.

3. The Deputy Commissioner of Income-tax, Circle 16(2), Aayakar Bhavan, Hyderabad.

4. The Asst. Commissioner of Income-tax, Circle-16(2), Hyderabad.

5. The CIT(A)-III, Hyderabad.

6. The CIT(A)-V, Hyderabad

7. The CIT-IV, Hyderabad

8. The CIT-II, Hyderabad.

9. The DR - B Bench, ITAT, Hyderabad tprao