* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **ITA No.1128 of 2010**

Reserved on:6th September, 2011
% Pronounced on:16th December,2011

M/s. COSMO FILMS LIMITED . . . APPELLANT

Through: Mr. Ajay Vohra, Advocate with Ms. Kavita Jha, Advocate and Mr. Somnath Shukla, Advocates.

VERSUS

COMMISSIONER OF INCOME TAX, NEW DELHI . . .RESPONDENT

Through: Mr. Abhishek Maratha, Sr. Standing Counsel.

CORAM :-

HON'BLE THE ACTING CHIEF JUSTICE
HON'BLE MR. JUSTICE J.R. MIDHA

A.K. SIKRI, ACTING CHIEF JUSTICE:

1. This appeal was admitted on the following substantial questions of law:

> "1. Whether on the facts and in the circumstances of the case, the Tribunal erred in law in holding that aggregate brought forward losses of the amalgamating company from both export and non-export activities were liable to be set off in determining "profit of the business" for computing deduction under Section 80JHHC of the Act?

> 2. Whether on the facts and in the circumstances of the case, the Tribunal erred in applying the ration of the decision rendered by the Hon'ble Supreme Court in the case of IPCA Laboratory Ltd. v. DCIT: 266 ITR 521, without appreciating that the issue in that case before the Apex Court was limited to set off of losses from one export business against profit from another export business, in computing the profit eligible for deduction under Section 80HHC of the Act?"

2. These questions have arisen in the following factual backdrop:

The appellant/assessee is engaged in the business of manufacturing BOPP film. The assessee company has substantial exports of BOPP film. During the previous year relevant to the assessment year 2003-04, Gujarat Propack Limited (engaged in manufacture and domestic sale of BOPP film) merged with the assessee company with effect from 01.4.2002. At the time of amalgamation, the amalgamating company had brought forward losses of ₹3,755/- lacs from non-export activity and ₹80.29 lacs from export activity. For the Assessment Year 2003-04, in the return of income, the assessee claimed deduction under Section 80HHC of the Income Tax Act (hereinafter referred to as 'the Act'). Subsequently, however, taking into account the decision of the Supreme Court in the case of ***IPCA Laboratory Limited Vs. DCIT***, 266 ITR 521 (SC) and ***SKF Bearings India Limited Vs. JCIT***, [2005] 4 SOT 534 (ITAT Mumbai), the assessee recomputed

deduction under that Section after setting off brought forward losses from export activity of ₹80.29 lacs with export profit.

3. Vide assessment order dated 31.3.2006, the Assessing Officer (AO) held that in computing deduction under Section 80HHC of the Act, brought forward losses from both export ad non-export activities were liable to be set off.

4. The CIT (A) vide order dated 22.12.2006 reversed the order of the AO and held that brought forward losses from export activity alone were liable to be set off in computing deduction under Section 80HHC of the Act, whereas brought forward losses from non-export activity are not liable to be so set off.

5. A further appeal by the Revenue culminated in its favour as the Income Tax Appellate Tribunal (hereinafter referred to as 'the Tribunal') vide impugned order, held the issue against the assessee/appellant.

6. Aggrieved by the impugned order dated 23.10.2009 passed by the Tribunal, the assessee has preferred the instant appeal before this Court giving rise to the aforesaid questions of law.

7. Submission of Mr. Ahay Vohra, learned counsel appearing for the assessee/appellant was that in terms of Section 78(2) of the Act, losses of one entity cannot be carried forward and set off in the hands of any other entity. Section 72A(1) of the Act lifts the

bar enshrined in Section 78(2) of the Act by providing that the unabsorbed business losses and unabsorbed depreciation of the amalgamated company, if the conditions laid down in that Section are fulfilled. His submission was that the deeming fiction in Section 72A of the Act has been enacted for a limited purpose, viz., that the unabsorbed business losses/unabsorbed depreciation of the amalgamating company is regarded as unabsorbed business losses/unabsorbed depreciation of the amalgamated company and available for carry forward and set off in the hands of the amalgamated company, overriding the provisions of Section 78(2) of the Act providing to the contrary. He, thus, argued that the legal fiction incorporated in Section 72A of the Act is limited in scope to the extent of deeming the unabsorbed business losses/unabsorbed depreciation of the amalgamating company as the unabsorbed business losses/unabsorbed depreciation of the amalgamated company for purposes of carry forward and set off of the same, cannot extend beyond as held in ***CIT Vs. Mother India Refrigeration Industries (P) Ltd.***, 155 ITR 711 (SC).

8. Mr. Vohra further pleaded that the scheme of Section 80HHC of the Act is that deduction is allowed for profit derived from export of qualifying goods or merchandise. Sub-section (3) of the said Section provides an artificial basis of computing profit derived

from export. In those cases where the assessee is engaged in the export of both manufacturing as well as trading goods, the deduction admissible under Section 80HHC of the Act is calculated in terms of Clause (c) of sub-Section (3) of that Section, by aggregating the profit/loss derived from export of manufactured goods and profit/loss derived from export of trading goods. This according to the learned counsel is the ratio of the judgment of the Apex Court in the case of ***IPCA Laboratory Limited*** *(supra)*, which is statutorily recognized in Section 80HHC (3)(c) of the Act. For calculating deduction under Section 80HHC(3)(c)(i) of the Act in respect of export of manufactured goods, 'profits of the business' have to be apportioned in the ratio of export turnover to total turnover. Clause (baa) of Explanation to the said Section defines "profits of the business" to mean the profits as assessed under the head "profits and gains of business or profession" subject to adjustments enumerated therein. The submission of the assessee is that the losses of the amalgamating company, which are not available for carry forward and set off in the hands of the amalgamated company, but for the provisions of Section 72A of the Act, cannot go to reduce/diminish the deduction under Section 80HHC of the Act available to the assessee in respect of profit derived from export activity. The set off of losses of the

amalgamating company, if any, has only to be restricted to the losses suffered in the export business, which can, at best be said to have nexus with the exports activity, and not the aggregate brought forward losses of the amalgamating company from both export as well as non-export business. The losses of the amalgamating company from domestic/non-export business, having no relation with the export activity cannot be considered to compute 'profit derived from export', which forms the basis of deduction under Section 80HHC of the Act.

9. He also argued that where a strict literal construction leads to an unjust and absurd result, not intended by the Legislature, such strict literal construction must give way and be substituted by a purposive/contextual interpretation. Since Section 80HHC is a beneficial Section to encourage exports out of India, resulting in earning of valuable foreign exchange, it would receive liberal consideration.

10. Mr. Vohra also argued that the Tribunal had misdirected itself in resting its decision entirely in the judgment of the Supreme Court in ***IPCA Laboratory*** *(supra)* inasmuch as the controversy which arises in the present case had not been considered by the Apex Court in ***IPCA Laboratory Limited*** *(supra)*.

11. Mr. Abhishek Maratha, learned counsel appearing for the Revenue, on the other hand, maintained that the case was squarely covered by the judgment of the Supreme Court in ***IPCA Laboratory Limited*** *(supra)*, which was rightly followed by the Tribunal. He submitted that the issue was discussed in detail in the said judgment and relied upon the discussion and reasoning contained therein.

12. The learned counsel also argued that the important factor in the present case was that the assessee company and the merged company were engaged in the same business of manufacture of BOPP film, which is used for laminating purpose and cardboard in the packaging industry. Section 80AB of the Act had an overriding effect upon all the Sections of Chapter – VIA except Section 80M of the Act. For this reason, deduction under Section 80HHC had to be restricted under Section 80AB read with Section 80B(5) of the Act. Therefore, deduction under Section 80HHC of the Act is allowable to the assessee to the extent of the income from the export included in the total income.

13. Apart from ***IPCA Laboratory (supra)***, Mr. Maratha, also referred to the judgment of the Supreme Court in the case of ***Synco Industries Ltd. Vs. Assessing Officer and Another***, 299 ITR 444 (SC).

14. We have considered the submissions of the counsel on either side in the light of the relevant provisions of the Act as well as the judgment of the Supreme Court in ***IPCA Laboratory*** *(supra)*. The moot aspect which needs determination pertains to the treatment that is to be given to brought forward losses of the amalgamating company from both export and non-export activities. It is not in dispute that Section 72 of the Act postulates carrying forward and set off of such losses of the amalgamating company in the hands of the amalgamated company. The question is whether losses both from export and non-export activities are liable to be set off, that too, while determining "profit of the business" for computing deduction under Section 80HHC of the Act. In the process, it is required to be seen as to whether this aspect is covered by the Supreme Court in ***IPCA Laboratory*** *(supra)*. Whereas the AO and the Tribunal have taken the view that the brought forward losses from both export and non-export activities were liable to be set off, in view of CIT (A), it is only brought forward losses from export activities (and not from non-export activities) which are liable to be set off in computing deduction under Section 80HHC of the Act. Before we advert to the deduction on this issue, we would like to take note of the relevant provisions.

15. The question would be as to whether ***IPCA Laboratory Ltd.*** (supra) decides this issue. When we go through the judgment in the said case, we find that the appellant had sought deduction under Section 80HHC of the Act for ₹3.78crores. During the assessment proceedings it was found that the appellants were exporting goods which were self manufactured as well as goods manufactured by supporting manufacturers i.e. trading goods. It was found that a sum of ₹ 3.78 crores which was claimed as deduction, was the profit from export of self manufactured goods. Insofar as export of trading of goods is concerned, there was a loss of ₹6.68 crores. The appellant did not want this loss to be taken into consideration and claimed deduction on the export profit earned from the export of goods which was self manufactured. The Supreme Court did not accept this contention of the appellant. On this basis it is argued by the learned counsel for the appellant that the said case was not a case where question of setting off loss from non-export activity had come up for consideration. At the same time we find that provision of Section 80HHC have been thoroughly considered, analysed and interpreted. The relevant discussion in this behalf runs from para 12 to 21 and it would be apt to extract the entire discussion contained in the aforesaid paragraphs.:-

"12. We are unable to accept the submission of Mr. Dastur, Undoubtedly Section 80HHC has been incorporated with a view to providing incentive to export houses. Even though a liberal interpretation has to be given to such a provision the interpretation has to be as per the wordings of this Section. If the wordings of the Section are clear then benefits, which are not available under the Section, cannot be conferred by ignoring or misinterpreting words in the Section. In this case we are concerned with the wordings of Sub-section 3(c) of Section 80HHC. As noted earlier Sub-section 3(a) deals with the case where the export is only of self manufactured goods. Sub-section 3(b) deals with the case where the export is only of trading goods. Thus when the Legislature wanted to take exports from self manufactured goods or trading goods separately, it has already so provided in Sub-section (3)(a) and (3)(b). **It would not be denied that the word "profit" in Section 80HHC(1) and Sections 80HHC (3)(a) and 3(b) means a positive profit. In other words if there is a loss then no deduction would be available under Section 80HHC (1) or (3)(a) or (3)(b). In arriving at the figure of positive profit, both the profits and the losses will have to be considered. If the net figure is a positive profit then the assessee will be entitled to a deduction. If the net figure is a loss then the assessee will not be entitled to a deduction. Sub-section 3(c) deals with cases where the export is of both self manufactured goods as well as trading goods.** The opening part of sub-section 3(c) states "profits derived from such export shall". Then follows (i) and (ii). Between (i) and (ii) the word "and" appears. A plain reading of Sub-section (c) shows that "profits from such exports" has to be profits of exports of self manufactured goods plus profits of exports of trading goods. The profit is to be calculated in the manner laid down in 3(c)(i) and (ii). **The opening words "profit derived from such exports" together with the word "and" clearly indicate that the profits have to be calculated by counting both the exports. It is clear from a reading of Sub-section (1) of Section 80HHC(3) that a deduction can be permitted only if there is a positive profit in the exports of both self manufactured goods as well as trading goods. If there is a loss in either of the two then that loss**

has to be taken into account for the purposes of computing profits.

13. **Under Section 80HHC(1) the deduction is to be given in computing the total income of the assessee. In computing the total income of the assessee both profits as well as losses will have to be taken into consideration. Section 80AB is relevant. It reads as follows:**

> **"80AB. Where any deduction is required to be made or allowed under any section included in this Chapter under the heading " C-Deductions in respect of certain incomes " in respect of any income of the nature specified in that section which is included in the gross total income of the assessee, then, notwithstanding anything contained in that section, for the purpose of computing the deduction under that section, the amount of Income of that nature as computed in accordance with the provisions of this Act (before making any deduction under this Chapter) shall alone be deemed to be the amount of income of that nature which is derived or received by the assessee and which is included in his gross total income."**

Section 80B(5) is also relevant. Section 80B(5) provides that "gross total income" means total income computed in accordance with the provisions of the Income Tax Act.

14. 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 VIA. 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. 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 of income 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.

15. Another reason why the argument of Mr. Dastur cannot be accepted is that even under Section 80HHC (3)(c)(i) the profit is to be adjusted 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 Section 3(c)(i), one necessarily has to reduce by profits under 3(c)(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 profits earned from export of both self manufactured goods and trading goods, the profits 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 under Section 80HHC(i). If there is a loss he will not be entitled to any deduction.

16. Mr. Dastur submitted that the word "profit" in Section 80 HHC must have the same meaning in the entire Section. He submitted that as the word profit in Section 80HHC (1) means only positive profit, it will have the same meaning in Section 80HHC (3)(c). He submitted that thus the word profit in Section 80HHC (3)(c) would not include losses and if there are any losses they are to be ignored. We are unable to accept this submission for more than one reason. Firstly it is not necessary that the word "profit" must have the same meaning. The meaning that the word "profit" will depend on the context in which it is used. In Section 80HHC (1) it is admittedly used to indicate positive "profit" because the deduction will only be of a positive profit. Section 80HHC(3) is the sub-section which provides how profits are to be worked out in computing total income. For purposes of such computation both profit and losses have to be taken into account. Thus the word "profit" in Section 80HHC(3) will mean profits

after taking into account losses, if any. More importantly, in our view, the term "profit" in Section 80HHC both in Sub-section (1) and in Sub-section (3) means a positive profit worked out after taking into consideration the losses, if any. Thus the word "profit" has the same meaning in Section 80HHC (1) and (3).

17. It was next submitted that even when the profits are to be reduced by the losses in cases where an export house has disclaimed its turn over in favour of a supporting manufacturer, the turn over of the exporter gets reduced to the extent disclaimed. It is submitted that as the turnover, which is disclaimed, is reduced it cannot then be taken into consideration for the purposes of computing profits under Sub-section 3(c)(ii). In our view this is an argument which merely needs to be stated to be rejected. If such an argument is accepted it would lead to an absurd result. It would mean when if there was no disclaimer the export house would not be entitled to any deduction in cases where there is a loss but because disclaimer has been made both the export house and the supporting manufacturer would become entitled to deductions. **The proviso to Sub-section (i) of Section 80HHC enables a disclaimer only to enable the export house to pass on deductions. It in no way reduces the turnover of the export house. In computing total income, the entire turnover is taken into account even though there is a disclaimer.** Thus even though the disclaimer is made the taxable income of Rs. 4.39 crores has been arrived at by the Appellants after taking into account the entire turnover from export of trading goods. In arriving at the figure of Rs. 4.39 crores admittedly the loss of Rs. 6.86 crores has been taken into account. Even after disclaimer the turnover has remained the turnover of the Export House i.e. the Appellants. The disclaimer is only for purposes of enabling the export house to pass on the deduction which it would have got to the supporting manufacturer. It follows that if no deduction is available, because there is a loss, then the export house cannot pass on or give credit of such non-existing deduction to a supporting manufacturer.

18. Faced with this situation, it was submitted that even a loss is a negative profit. In support of the submission, reliance was placed upon the authority of

this Court in the case of Commissioner of Income-Tax(Central), Delhi v. Harprasad & Co. P. Ltd. reported in 1975 (Vol. 99) ITR 118. In this case the meaning of loss was being considered in the context of capital gains made from sale of shares. The question was whether the loss could be carried forward and set off against capital gains in a subsequent year. While considering this question, it was held as follows:

"From the charging provision of the Act, it is discernible that the words "income" or "profits and gains" should be understood as including losses also, so that, in one sense "profits and gains" represent "plus income" whereas losses represent "minus income". In other words, loss is negative profit. Both positive and negative profits are of a revenue character. Both must enter into computation, wherever it becomes material, in the same mode of the taxable income of the assessee."

19. In our view, the above observations are against the Appellants. They show that in computing income profits and gains, losses must also be taken into consideration.

20. Mr. Dastur relied on a format of Form No. 10CCAC and a Circular of the Board wherein it is stated as follows:

> "With the adoption of the dual system for computing export profit, the computation of the disclaimed export turnover also required modification. The Finance Act has therefore amended Section 80HHC in order to provide that, where the Export or Trading House disclaims the tax concession in favour of the supporting manufacturer, the concession to the Export or Trading House will be reduced by the amount which bears to the total export profits of trading goods the same proportion as the disclaimed export turnover bears to the total export turnover of trading goods. The formula in such cases will now be -
>
> 80HHC concession = export profit [export profits on trading goods x disclaimed export turnover/total export turnover"

> Mr. Dastur submitted that if even both profits and losses are to be taken into account the, on a disclaimer the losses will also have to be considered as negative profits and as per the Board Circular the calculation would be as follows:
>
> "80HHC Concession =
>
> *Export Profits - [Export Profits on Trading Goods x Disclaimed Export Turnover]/ Total Export Turnover of Trading Goods……..
>
> ……He submitted that even on this calculation the Appellants are entitled to deduction of Rs. 3,78,80,937/-. We are unable to accept this submission. The calculation as per the Board Circular would not be as claimed. The Board Circular nowhere provides for negative profits. The Board Circular also shows that only positive profits can be considered for purposes of deduction.
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> 21. We, therefore, see no substance in the Appeal. The same stands dismissed. There shall be no order as to costs."

16. The highlighted portion from the extracted passages would clearly demonstrate that the Supreme Court considered the scope of expression "profit" occurring in Section 80HHC and in no uncertain term held that it would mean a positive profit. It was clearly held that if there is a loss than no deduction would be available under this provision. The Court further clarified that for arriving at positive profit, both the profits and the losses will have to be considered. It is only when the net figure is a positive profit then the assessee is entitled to deduction. Once that judgment is

applicable which answers the question, it is not necessary to deal with other submissions of the learned counsel for the appellant.

17. Having regard to this interpretation given to Section 80HHC by the Apex Court, it necessarily follows that to arrive at a net figure of positive profits, losses from export as well as non-export activities are to be taken into consideration. We are thus of the opinion that the matter is squarely cover by the judgment of the Supreme Court in ***IPCA Laboratory*** (supra) and the Tribunal rightly relied upon the aforesaid judgment while deciding the issue. It is to be borne in mind that the assessee company and the merged company were engaged in the same business of manufacturing of BOPP film which is used for laminating papers and card board in the packaging industry. Further as held by the Supreme Court in the aforesaid case, Section 80 AB of the Act has the overriding effect upon all the sections of Chapter 6-A except Section 80 M of the Act. Therefore, the deduction under Section 80HHC is restricted by the said provision namely Section 80AB of the Act. It is rightly demonstrated by the learned counsel for the respondent that in such circumstances, the deduction under Section 80HHC of the Act is to be calculated as under:-

A. The Income of Business computed by the assessee	₹52,51,56,119/-
B. Brought Forward losses	₹ 38,36,03,835/-

C. Positive Profit (as per IPCA) to be considered for deduction u/s80HHC of the Act	A-B=₹ 14,15,52,284/-
D. Less 90% of ₹ 39,84,891/- (the insurance and other income)	(90% of ₹ 39,84,891/-) ₹ 35,96,402/-.
E. Less 90% of incentives	(90% of incentives) ₹ 13,38,43,759/-
F. Positive Profit for deduction u/s80HHC of the Act	C-D+E+₹ 41,22,123
G. Export Turn Over computed by the assessee	₹ 81,20,35,070/-
H. Total turnover computed by the assessee	₹2,96,70,13,378/-

Formula:

Deduction u/s 80HHC=Profit of Business X Export Turn Over/Total Turn Over.

₹41,22,123/- X ₹ 81,20,35,070/- ₹ 2,96,70,13,378/-
50% deduction allowed to the assessee=50% of ₹11,28,174/-= ₹ 5,64,087/-

18. The same view is reiterated by the Supreme Court in the case of ***Synco Industries Ltd.****(supra)* in the context of Section 80-I of the Act. The principle underlying both the Sections, insofar as computation is concerned, is the same and, therefore, this judgment following ***IPCA Laboratory*** *(supra)* would be squarely applicable.

19. We thus answer the questions, as framed, in the negative holding that the Tribunal rightly decided the issue applying the ratio of ***IPCA Laboratory*** (supra). As a result, the appeal is dismissed.

ACTING CHIEF JUSTICE

(J.R. MIDHA)
JUDGE

DECEMBER 16, 2011
Pmc/skb