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

Reserved on: 12.01.2017
Pronounced on: 16.02.2017

\+ **ITA 166/2004**

ROLLATAINERS LTD. ..... Appellant
Through: Ms. Kavita Jha and Sh. Vaibhav Kulkarni, Advocates.

Versus

COMMISSIONER OF INCOME TAX ..... Respondent
Through: Ms. Vibhooti Malhotra, Advocate.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE NAJMI WAZIRI

MR. JUSTICE S. RAVINDRA BHAT

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1. This is an assessee's appeal under Section 260A of the Income Tax Act, 1961 ("the Act") against the consolidated order of the Income Tax Appellate Tribunal ("ITAT") (Delhi Bench) dated 30.07.2003. The following questions of law were framed for consideration, at the time of admission of the appeal:

i. Whether on the facts and in the circumstances of the case the Tribunal was correct in law in holding that deduction under Section 80HHC of the Income Tax Act had to be computed by apportioning the profits of the entire business in the ratio of export turnover to total turnover of the entire business?

ii. Whether on the facts and in the circumstances of the case the Tribunal erred in holding that for calculating profits derived from

export of trading goods, indirect costs that need to be reduced from the export turnover of such goods had to be computed with reference to all costs and not only those costs which were attributable to export of trading goods?

iii. Whether on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that the write back of liabilities is squarely covered by the expression "any other receipt of similar nature" and consequently 90% thereof was to be excluded from profits of the business in terms of explanation (baa) of Section 80HHC of the Act?

2. The assessee is engaged in the business of manufacturing packaging cartons and packaging machinery. It carries out its activities under the following divisions:

a) Packaging division
b) Paper Board division
c) Machine Manufacture division
d) Writing and specialty paper division
e) Machine Trading Division.

3. During the relevant assessment years i.e. 1994-95, the assessee exported cartons from the packaging division, packaging machines and bought out components from the Machine Trading division. In addition to exports, these divisions also had local sales. The assessee in its return of income for the assessment years 1994-95 claimed deduction under Section 80HHC of the Act for ₹ 48,75,358. It claimed deduction under Section 80HHC(3)(a) of the Act on division-wise basis, i.e. by taking the total profit of each division which had made exports and thereafter computing the

deduction in the same ratio as export turnover of the division bore to the total turnover of that division. The profits and turnover derived from other divisions were not considered while computing deduction under Section 80HHC for a particular division. The Assessing Officer (AO), while framing the assessment order clubbed the profits and turnover of all the divisions and allowed deduction under Section 80HHC of the Act by considering the various divisions of the assessee as one business.

4. During the relevant assessment year, the assessee was also engaged in the business of export of trading as well as manufacture of goods. The assessee claimed deduction under Section 80HHC of the Act in respect of its trading activity at ₹ 36,27,283. However, in computing the "indirect cost" of trading goods, the AO reduced the claim to ₹17,42,565 thus denying deduction on a sum of ₹18,84,718. The assessee had also written back ₹13,80,000 on account of liabilities and miscellaneous balances no longer required, which formed part of taxable profits. The AO excluded 90% of the said amount while calculating the "profits of the business" for the purposes of Section 80HHC of the Act. Aggrieved by the orders of the AO, the assessee appealed to the Commissioner of Income Tax (Appeals) ("CIT(A)"), challenging the restrictions on deductions claimed under Section 80HHC of the Act. The CIT(A) confirmed the AO's order as regard computation of deduction allowable under Section 80HHC of the Act with respect to the profits and total turnover of the entire business. With regard to the computation of indirect cost in respect of export of trading goods, the CIT (A) reversed the AO's order and upheld the calculation adopted by the assessee. In relation to the exclusion of 90% of the amounts written back, the CIT(A) held that 90% of such amount could not be reduced for working out

profits of the business and accordingly directed the AO to recompute admissible deduction under Section 80HHC of the Act.

5. Aggrieved by the orders of the CIT(A), both the Revenue and the assessee filed appeals before the ITAT. In respect of the question as to whether the deduction under Section 80HHC had to be calculated with reference to the profits and turnover of the divisions carrying on export business only, or the entire business of the assessee had to be considered, the ITAT found in favor of the Revenue. In relation to the computation of the "indirect costs", the ITAT found that the method adopted by the assessing officer could not be faulted and therefore, reversed the CIT (A)'s order on that issue. As regards the issue of exclusion of amounts written back by the assessee, the ITAT set aside the order of the CIT(A) and confirmed the AO's order. The assessee therefore appeals to this court.

Proceedings before the CIT(A) and ITAT

6. The assessee had contended before the CIT(A), that deduction under Section 80HHC had to be based on the profits and turnover of only the export divisions of its business, without taking into account the entire business, i.e without including those divisions that were unrelated to export activity. The assessee contended that each division of the assessee's business was a separate unit for which separate accounts were maintained and therefore deduction under Section 80HHC should be computed with reference to export turnover and total turnover of the exporting division separately, instead of the entire business as a whole. In relation to the quantum of "indirect costs", the assessee contended that only those amounts could be considered which had some nexus with the export costs, and not all costs debited to the P&L Account including manufacturing expenses, which

had no nexus with the export of trading goods. Further, in relation to the exclusion of 90% of the amounts written back, the assessee contended that since such written back liabilities were not in the nature of brokerage, commission, interest rent, charges or any other receipt of a similar nature, such amounts would not fall within Explanation (baa) of Section 80HHC. The CIT (A) however rejected this argument, holding that computation of admissible deduction had to be with reference to the total turnover of the entire business as a whole and not just the export division separately. As regards computation of "indirect costs", the CIT(A) held that since deduction under Section 80HHC on merchant export was admissible on merchant export turnover as reduced by direct and indirect cost of export, it would not be appropriate to apportion a part of the manufacturing cost to the cost of merchant exports. Here, the asssessee succeeded, because the CIT (A) ruled that the computation of "indirect costs" had to be with reference to the costs that had some relation to the export of trading goods. With regard to the written back liabilities, the CIT(A) held that such amounts would not be covered under Explanation (baa) as they were not in the nature of brokerage, commission etc. On that basis, the CIT(A) proceeded to delete the exclusion of such written back liabilities from the profits of business as computed under Explanation (baa). Against this order of the CIT(A), both the assessee and the Revenue preferred appeals before the ITAT.

7. Before the ITAT, the assessee placed reliance on the decision of the Madras High Court in *CIT v. Madras Motors Ltd.*, 257 ITR 60, where it was held that while computing profits under Section 80HHC, the turnover of exports should be taken and not the total turnover. The ITAT, however, rejected the assessee's contention and placed reliance on the Tribunal's

decision in the case of *International Park Research Laboratory v.* CIT, 50 ITD 37 and the decision of the Kerala High Court in *CIT v. Parry Agro Industries Ltd.,* 257 ITR 41, stating that "total turnover" unambiguously referred to the total turnover of the entire business and not just the turnover of exports. In relation to the computation of "indirect costs", the ITAT found that the computation by the AO was in accordance with the definition of "indirect costs" provided in Explanation (e) to Section 80HHC(3). Therefore, on this issue, the ITAT reversed the findings of the CIT(A) and upheld the computation of the AO. Regarding the amounts written back by the assessee, the ITAT held that such written back liabilities are squarely covered by the expression "any other receipt of similar nature" in Explanation (baa) of Section 80HHC and such amounts had to be excluded from the "profits of the business". Thus, on the third issue as well, the Tribunal found in favour of the Revenue and reversed the order of the CIT(A).

<u>Question (a)</u>

8. Section 80HHC was introduced by the Finance Act of 1983, with effect from 01.04.1983 to provide incentives to exporters and allow for deductions for persons involved in the export business. The relevant parts of Section 80HHC are extracted below:

> "(1) *Where an assessee, being an Indian company or a person (other than a company) resident in India, is engaged in the business of export out of India of any goods or merchandise to which this section applies, there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction to the extent of profit, referred to is sub-section (1B) derived by the assessee from the export of such goods or merchandise:*

Provided that if the assessee, being a holder of an Export House Certificate or a Trading House Certificate, (hereafter in this section referred to as an Export House or a Trading House, as the case may be,) issues a certificate referred to in clause (b) of sub-section (4A), that in respect of the amount of the export turnover specified therein, the deduction under this subsection is to be allowed to a supporting manufacturer, then the amount of deduction in the case of the assessee shall be reduced by such amount which bears to the total profits derived by the assessee from the export of trading goods, the same proportion as the amount of export turnover specified in the said certificate bears to the total export turnover of the assessee in respect of such trading goods.

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(3) For the purposes of sub-section (1), –
(a) where the export out of India is of goods or merchandise manufactured or processed by the assessee, the profits derived from such export shall be the amount which bears to the profits of the business, the same proportion as the export turnover in respect of such goods bears to the total turnover of the business carried on by the assessee;
(b) where the export out of India is of trading goods, the profits derived from such export shall be the export turnover in respect of such trading goods as reduced by the direct costs and indirect costs attributable to such export;
(c) where the export out of India is of goods or merchandise manufactured or processed by the assessee and of trading goods, the profits derived from such export shall, –

(i) in respect of the goods or merchandise manufactured or processed by the assessee, be the amount which bears to the adjusted profits of the business, the same proportion as the adjusted export turnover in respect of such goods bears to the adjusted total turnover of the business carried on by the assessee; and

(ii) in respect of trading goods, be the export turnover in respect of such trading goods as reduced by the direct and indirect costs attributable to export of such trading goods."

9. The first question that arises before the court is what is meant by the term, "*total turnover of the business carried on by the assessee*". On this point, the ITAT has relied on the decision of the Kerala High Court in *Parry Agro (supra)* as well as the decision of the Special Bench of the ITAT (Delhi) in *International Park Research Laboratory (supra)* to hold that the expression "total turnover" refers to the total turnover of the entire business of the assessee. The assessee relied on the decision of the Madras High Court in *Madras Motors Ltd. (supra)* for saying that "total turnover of the business" can only mean the total turnover from the export business of the assessee. In *Madras Motors* (supra) it was held that:

"8. It cannot be forgotten that the assessee's business is not exclusively of export in the sense that it has the income out of the local sales of forgings also and as such, it would be governed by clause (b) of sub-section (3). However, that is not the be all and end all of the matter as the whole section pertains to defined goods. Sub-section (1) very clearly provides a rider for the application of section 80HHC in the opening words itself which are as follows :

"80HHC. Deduction in respect of profits retained for export business.(1) Where an assessee, being an Indian company or a person (other than a company) resident in India, is engaged in the business of export out of India of any goods or merchandise to which this section applies, there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction of the profits derived by the assessee from the export of such goods or merchandise."

The goods or merchandise to which the whole section applies are to be found in clause (a) of sub-section (2). The language is extremely important and hence would reproduce the said sub-section.

"(2)(a) This section applies to all goods or merchandise, other than those specified in clause (b), if the sale proceeds of such goods or merchandise exported out of India are receivable by the assessee in convertible foreign exchange."

Therefore, it is crystal clear that the whole section 80HHC applies only to the goods which are not only exported out of India but the sale proceeds of which are receivable in convertible foreign exchange. When we sit to consider sub-section (3), clause (a) thereof speaks about the assessee who has an exclusive business of exports of such goods or merchandise. Clause (a) would apply where the assessee has no other business meaning all his income would be out of the export sales, the proceeds of which are receivable in convertible foreign exchange. There is again almost by way of abundant caution the user of the words "goods or merchandise" to which this section applies. Once we have this stage then the task of interpreting clause (b) of sub-section (3) becomes easier because even in clause (a) of sub-section (2) and clause (a) of sub-section (3) the same terminology is used in respect of the goods and merchandise. When a plain meaning has to be given to the opening part of the section, it is clear that the word "business" means the business relating to the goods to which the section applies and the thrust is on the word "exclusively". The sub-section considers a situation where the assessee's business is of exports and the assessee's business is not that of export alone. However, one thing is certain that the business has to be only in respect of the goods or merchandise to which the section applies. As has been stated earlier, the thrust is on the word "exclusively". The legislature has rightly intended the situation where the business could be relating to the goods which would fetch the foreign exchange but there could also be the business in relation to these goods which may not be exported or which may not fetch foreign exchange. However, the whole sub-section speaks only about the goods,

which are exportable, exported and fetch foreign exchange. It is, therefore, clear that the thrust of the opening clause of clause (b) of sub-section (3) has a stress on the words "does not consist, exclusively of the export". The sub-section takes into consideration the situation of income out of the export of the goods vis-a-vis the income out of those goods other than by way of exports. The words "total turnover of the business" would then be controlled by and have to be read in the colour of the opening clause. The formula envisaged by the section would be "export turnover/total turnover x profits and gains of business". The business contemplated in the section would be restricted to only the goods to which the section applies and, therefore, by necessary implication even the total turnover of the business would be the total turnover of the business of the goods to which the section applies. If we include the turnover of the goods to which the section does not apply, it would amount to doing violence to the language of the sub-section itself. The sub-section has been created only to see the ratio of the income out of the export to the total income out of the business in respect of those goods because of the obvious difficulty of segregating the profits earned out of export alone vis-a-vis the profits earned otherwise than by export. The total profits earned out of the business of such goods are not exemptible because those profits would include both profits out of exports and the profits earned otherwise than by export but one thing is certain that the business contemplated in the sub-section would be in relation to those goods alone to which the section applies as per clause (a) of sub-section (2). Once we read sub-section (1) of section 80HHC, clause (a) of sub-section (2) and clauses (a) and (b) of sub-section (3), there remains no doubt that the total turnover of the business would contemplated only the business regarding such goods part of which are exported and the others are not so exported. <u>There is just no scope to include the turnover of the business of the goods which are not contemplated by the section. That way, though the legislature has specified about the applicability of the section to the goods by clause (a) of sub-section (2), we would be unnaturally making the section applicable even to the goods which are</u>

> *outside the limits of clause (a) of sub-section (2) and that will not be permissible*.
> 9. *Once this situation is clear, there would be no scope of accepting the argument of revenue that the total turnover of business would include even the turnover of the goods which are outside the scope of clause (a) of sub-section (2). Hence, we are of the clear opinion that the turnover from the business of sale of motorcycles, motorcycle spare parts, television sets cannot be introduced to inflate the total turnover artificially in order to reduce the benefit which the assessee is entitled to. That would be clearly going against the object of section 80HHC, which is solely to encourage the exports*."

10. The above decision of the Madras High Court was followed and applied by this Court in *Commissioner of Income Tax v. Padmini Technologies,* 2011 VIII AD (Delhi) 425, where the Court interpreted the term "*total turnover of the business*" in Section 80HHC. This Court held that:

> *"It is pertinent to note that the revenue has not assailed before us the finding of fact returned by the Tribunal that in so far as the two businesses were concerned, they were carried on in two separate undertakings. It was also not disputed that in respect of the said undertakings, the Assessee maintained separate books of accounts and also prepared separate profit and loss accounts and balance sheets. In the judgment of Madras Motors Ltd. (supra), the rationale given is that the word "business" which follows the expression "total turnover" would have to be confined to only those goods to which the section applies. Therefore, by necessary implication, the total turnover of business would only mean total turnover of business of goods to which the section applies. Inclusion of turnover of goods to which the section does not apply, would be doing violence to the language of Sub-section (3)(b). Sub-section (3) is inserted only to determine the deductible profits out of the total profits of business which can be attributed to the export*

business. We are in respectful agreement with the rationale adopted by the Madras High Court in Madras Motors Ltd. (supra). As a matter of fact, there could be a circumstance where one unit is completely engaged in export and not partially as was the case in Madras Motors Ltd. (supra). In those circumstances, there would be no occasion for disallowing a portion of the export earnings by adopting formula provided in Section 80HHC of the Income Tax Act. This view was taken by the Madras High Court not only in Rathore Brothers (supra) but also in M.Gani and Company(supra) which in turn followed yet another judgment of the Madras High Courtin the case of CIT v. Suresh B. Mehta MANU/TN/7542/2007 : (2007) 291 ITR 462.

In our opinion, the view taken by the Tribunal is in conformity with the decision of the Madras High Court, with which we are in respectful agreement. Therefore, we do not propose to frame a question of law on this issue. It is ordered accordingly."

11. Since the decision of this Court was pronounced in the year 2011, the ITAT in its decision in 2003 did not have the benefit of considering this Court's decision. Seeing that this question has been answered by the Madras High Court and the same has been followed by this Court, we are of the opinion that no substantial question of law arises on this issue. The ITAT's decision on the first question is thus reversed and is answered in favour of the assessee.

Question (b)

12. The second question concerns the interpretation of the term "indirect costs" which is defined in Explanation (e) to sub-section (3) of Section 80HHC. Explanation (e) reads:

"*Explanation: For the purposes of this subsection,-*

> *(e) "indirect costs" means costs, not being direct costs, allocated in the ratio of the export turnover in respect of trading goods to the total turnover;*"

13. In this case, the AO in computing the "indirect costs" has taken into consideration all costs (other than the direct costs) debited to the Profit and Loss account, such as manufacturing costs, which are not related to the export turnover. The ITAT in its decision held that the same was in conformity to the method prescribed under the statute. On this point, the Supreme Court in *Hero Exports v. Commissioner of Income Tax*, (2007) 13 SCC 1**,** had the occasion to interpret the term "indirect costs" as defined in Explanation (e) to Section 80HHC(3). The Court in that case held as follows:

> "*Under Section 80HHC(3)(b) which is the main section, the Legislature has provided that in cases falling under Section 80HHC(3)(b) <u>direct and indirect costs attributable to such exports</u> have to be deducted from the export turnover to arrive at Export Profits. Similar provision is made in Clause (d) which defines the words "direct costs" to mean costs attributable to exports of trading goods. Moreover, Clause (e) of the Explanation defines "indirect costs" as costs which is not direct costs as defined in Clause (d).*
>
> *Firstly, Clause (e) to the Explanation which refers to allocation of costs applies to Sections 80HHC(3)(b), 80HHC(3)(b) and 80HHC(3)(c). Secondly, Section 80HHC(3)(b) equates export profits to export turnover less direct and indirect costs <u>attributable to the exports of trading goods</u>. Therefore, the principle of attribution is retained. Thirdly, keeping in mind the provisions of Section 80HHC(3)(b) read with Clauses (d) and (e) of the Explanation it is clear that Legislature intended allocation of costs between export turnover and total turnover.*

14. It is thus clear that Explanation (e) which defines "indirect costs" has to be read in conjunction with sub-section (3)(c)(ii) of Section 80HHC, which provides that the profits shall be reduced by the "*direct and indirect costs attributable to export of such trading goods*." Since the word "attributable" has been used, it is clear that the indirect costs also must be attributable to the export of such goods; in other words, there must be some nexus that the "indirect costs" have to the export turnover of the assessee. *Au contraire*, if the term "indirect costs" is interpreted to also include such costs which are not attributable to the export of trading goods, then that would go against the language of the provision, as clarified by the Supreme Court. That being the position, in view of the declaration of the law in *Hero Exports (supra),* "indirect costs" computed must have some nexus (or in other words must be "attributable") to the export of trading goods. The decision of the ITAT on this question is therefore reversed.

Question (c)

15. The third question involves interpretation of Explanation (baa) to Section 80HHC. Explanation (baa) reads:

> "*Explanation : For the purposes of this section, –*
> *(baa) "profits of the business" means the profits of the business as computed under the head "Profits and gains of business or profession" as reduced by-*
> *(1) ninety per cent of any sum referred to in clauses (iiia), (iiib), (iiic), (iiid) and (iiie) of section 28 or of any receipts by way of brokerage, commission, interest, rent, charges or any other receipt of a similar nature included in such profits; and*
> *(2) the profits of any branch, office, warehouse or any other establishment of the assessee situate outside India;"*

16. The assessee submits - and it is argued on its behalf that Section 80HHC (3) requires that profits derived from export should mean the amount that bears to the profits of the business same ratio as the export turnover bears to the total turnover of the business carried on by the assessee. Further Explanation (baa) to s. 80HHC defines the "profits of the business" as profits of the business as computed under the head "Profits and gains of business or profession" as reduced by the specified deductions. It is contended that the items to be excluded from the profits of the business have to be seen in the context of the assessee's business activities. In the case of a manufacturing company which undertakes exports, receipt of interest or commission may not be operational income because they do not have the element of turnover and consequently Explanation (baa) will apply. However, that would not be the case if the assessee were carrying on financing business because the interest income which accrues will have the element of turnover and in such a case, receipts like interest will not attract Explanation (baa). Broadly, the Revenue has to consider the memorandum and articles of association of the company, the nature of the business, the nature of the activity and such other tests. It also has to verify what is the dominant business of the company and whether receipts like interest, commission, etc., accrue as a part of the main business activity or whether they accrue out of incidental business.

17. In the present case, the ITAT has held that the written back amount was squarely covered by the expression “any other receipt of similar nature” used in Explanation (baa) of Section 80HHC. Therefore, the question before this Court is with respect to the interpretation of the term “*any other receipt of a similar nature*” in Explanation (baa). It is trite to say that such a term occurring in a statute must be interpreted *ejusdem generis*. In this context,

the Supreme Court had the occasion to deal with the interpretation of Explanation (baa) in the case of *Commissioner of Income Tax v. K. Ravindranathan Nair,* (2007) 15 SCC 1:

> "*18. ……..The above discussion indicates that the formula in Section 80HHC(3) of the I.T. Act provided for a fraction of export turnover divided by total turnover to be applied to Business Profits calculated after deducting 90% of the sums mentioned in Clause (baa) to the said Explanation. That, profit incentives and items like rent, commission, brokerage, charges etc. though formed part of gross total income had to be excluded as they were* ***"independent incomes"*** *which had no element of export turnover. That, the said items distorted the figure of export profits.*
> *19. In our view, for the above reasons, the said processing charges, which was part of gross total income, was an independent income like rent, commission, brokerage etc. and, therefore, 90% of the said sum had to be reduced from the gross total income to arrive at the Business Profits and since the said processing charge was an important component of Business Profits, it also had to be included in the total turnover in the said formula to arrive at business profits in terms of Clause (baa) to the said Explanation.*
> *21. ………This aspect needs to be kept in mind while interpreting Clause (baa) to thesaid Explanation. The said clause stated that 90% of incentive profits or receipts by way of brokerage, commission, interest, rent, charges or any other receipt of like nature included in Business Profits, had to be deducted from Business Profits computed in terms of Sections 28 to 44D of the I.T. Act. In other words, receipts constituting independent income having no nexus with exports were required to be reduced from Business Profits under Clause (baa). A bare reading of Clause (baa)(1) indicates that receipts by way of brokerage, commission, interest, rent, charges etc. formed part of gross total income being Business Profits. But for the purposes of working out the formula and in order to avoid distortion of arriving export profits Clause (baa) stood inserted to say that although incentive profits and "independent*

> *incomes" constituted part of gross total income, they had to be excluded from gross total income because such receipts had no nexus with the export turnover. Therefore, in the above formula, we have to read all the four variables. On reading all the variables it becomes clear that every receipt may not constitute sale proceeds from exports. That, every receipt is not income under the I.T. Act and every income may not be attributable to exports*."

18. Therefore, the Supreme Court in *K. Ravindranathan (supra)*has taken the view that Explanation (baa) deals with such receipts which although constitute "independent incomes" of the assessee, are incomes that are not relatable to the exports of the assessee. Since Section 80HHC aims to incentivize exports, it is necessary that all incomes of the assessee which are not related to exports be excluded while calculating the profits of business under this section, such that the assessee cannot claim the benefit of this section in respect of "independent incomes" which have no relation to export activity. That being the case, the phrase "*any other receipt of a similar nature*" must necessarily relate to incomes under the Act which are not attributable to the export activity of the assessee.

19. In this context, in order to arrive at the "profits of the business" in terms of Explanation (baa), the "profits and gains of business or profession" of the assessee has to be computed under the provisions of Sections 28 to 43C of the Act. With respect to liabilities written back, Section 41 provides:

> *"(1) Where an allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee (hereinafter referred to as the first-mentioned person) and subsequently during any previous year, -*
>
> *(a) the first-mentioned person has obtained, whether in cash or in any other manner whatsoever, any amount in respect of such*

> *loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by such person or the value of benefit accruing to him shall be deemed to be profits and gains of business or profession and accordingly chargeable to income-tax as the income of that previous year, whether the business or profession in respect of which the allowance or deduction has been made is in existence in that year or not*;"

Therefore, written back liabilities are considered as profits and gains of business or profession under Section 41(1) of the Act, and thus would be relevant for computation of the "profits of the business" under Explanation (baa).

20. Once it is established that written back liabilities are considered as profits and gains of business or profession under the Act, for the purposes of Section 80HHC what needs to be seen is whether such profits are relatable to export or would they constitute "independent incomes" which according to *K. Ravindranathan (supra)* would have to be excluded by virtue of Explanation (baa).

21. In a subsequent judgment, reported as *ACG Associated Capsules (P) Ltd. v Commissioner of Income Tax* [2012] 247 CTR 372 (SC) the issue was examined by the Supreme Court, which held as follows:

> *"10. Under cl. (1) of Expln. (baa), ninety per cent of any receipts by way of brokerage, commission, interest, rent, charges or any other receipt of a similar nature included in any such profits are to be deducted from the profits of the business as computed under the head "Profits and gains of business or profession". The expression "included in such profits" in cl. (1) of the Expln. (baa) would mean only such receipts by way of brokerage, commission, interest, rent, charges or any other receipt which are included in the profits of the business as*

computed under the head "Profits and gains of business or profession". Therefore, if any quantum of the receipts by way of brokerage, commission, interest, rent, charges or any other receipt of a similar nature is allowed as expenses under ss. 30 to 44D of the Act and is not included in the profits of business as computed under the head "Profits and gains of business or profession", ninety per cent of such quantum of receipts cannot be reduced under cl. (1) of Expln. (baa) from the profits of the business. In other words, only ninety per cent of the net amount of any receipt of the nature mentioned in cl. (1) which is actually included in the profits of the assessee is to be deducted from the profits of the assessee for determining "profits of the business" of the assessee under Expln. (baa) to s. 80HHC.

11. For this interpretation of Expln. (baa) to s. 80HHC of the Act, we rely on the judgment of the Constitution Bench of this Court in Distributors (Baroda) (P) Ltd. vs. Union of India & Ors. (supra). Sec. 80M of the Act provided for deduction in respect of certain intercorporate dividends and it provided in sub-s. (1) of s. 80M that "where the gross total income of an assessee being a company includes any income by way of dividends received by it from a domestic company, there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction from such income by way of dividends an amount equal to" a certain percentage of the income mentioned in this section. The Constitution Bench held that the Court must construe s. 80M on its own language and arrive at its true interpretation according to the plain natural meaning of the words used by the legislature and so construed the words "such income by way of dividends" in sub-s. (1) of s. 80M must be referable not only to the category of income included in the gross total income but also to the quantum of the income so included. Similarly, Expln. (baa) has to be construed on its own language and as per the plain natural meaning of the words used in Expln. (baa), the words "receipts by way of brokerage, commission, interest, rent, charges or any other receipt of a similar nature included in such profits" will not only refer to

the nature of receipts but also the quantum of receipts included in the profits of the business as computed under the head "Profits and gains of business or profession" referred to in the first part of the Expln. (baa). Accordingly, if any quantum of any receipt of the nature mentioned in cl. (1) of Expln. (baa) has not been included in the profits of business of an assessee as computed under the head "Profits and gains of business or profession", ninety per cent of such quantum of the receipt cannot be deducted under Expln. (baa) to s. 80HHC.

12. If we now apply Expln. (baa) as interpreted by us in this judgment to the facts of the case before us, if the rent or interest is a receipt chargeable as profits and gains of business and chargeable to tax under s. 28 of the Act, and if any quantum of the rent or interest of the assessee is allowable as an expense in accordance with ss. 30 to 44D of the Act and is not to be included in the profits of the business of the assessee as computed under the head "Profits and gains of business or profession", ninety per cent of such quantum of the receipt of rent or interest will not be deducted under cl. (1) of Expln. (baa) to s. 80HHC. In other words, ninety per cent of not the gross rent or gross interest but only the net interest or net rent, which has been included in the profits of business of the assessee as computed under the head "Profits and gains of business or profession", is to be deducted under cl. (1) of Expln. (baa) to s. 80HHC for determining the profits of the business.

13. The view that we have taken of Expln. (baa) to s. 80HHC is also the view of the Delhi High Court in CIT vs. Shri Ram Honda Power Equip (supra) and the Tribunal in the present case has followed the judgment of the Delhi High Court. On appeal being filed by the Revenue against the order of the Tribunal, the High Court has set aside the order of the Tribunal and directed the AO to dispose of the issue in accordance with the judgment of the Bombay High Court in CIT vs. Asian Star Co. Ltd. (supra). We must, thus, examine whether reasons given by the High Court in its judgment in CIT vs. Asian Star Co. Ltd. (supra) were correct in law.

14. On a perusal of the judgment of the High Court in CIT vs. Asian Star Co. Ltd. (supra), we find that the reason which weighed with the High Court for taking a different view, is that rent, commission, interest and brokerage do not possess any nexus with export turnover and, therefore, the inclusion of such items in the profits of the business would result in a distortion of the figure of export profits. The High Court has relied on a decision of this Court in CIT vs. K. Ravindranathan Nair (2007) 295 ITR 228 (SC) in which the issue raised before this Court was entirely different from the issue raised in this case. In that case, the assessee owned a factory in which he processed cashew nuts grown in his farm and he exported the cashew nuts as an exporter. At the same time, the assessee processed cashew nuts which were supplied to him by exporters on job work basis and he collected processing charges for the same. He, however, did not include such processing charges collected on job work basis in his total turnover for the purpose of computing the deduction under s. 80HHC(3) of the Act and as a result this turnover of collection charges was left out in the computation of profits and gains of business of the assessee and as a result ninety per cent of the profits of the assessee arising out of the receipt of processing charges was not deducted under cls. (1) of the Expln. (baa) to s. 80HHC. This Court held that the processing charges was included in the gross total income from cashew business and hence in terms of Expln. (baa), ninety per cent of the gross total income arising from processing charges had to be deducted under Expln. (baa) to arrive at the profits of the business. In this case, this Court held that the processing charges received by the assessee were part of the business turnover and accordingly the income arising therefrom should have been included in the profits and gains of business of the assessee and ninety per cent of this income also would have to be deducted under Expln. (baa) to s. 80HHC of the Act. In this case, this Court was not deciding the issue whether ninety per cent deduction is to be made from the gross or net income of any of the receipts mentioned in cl. (1) of the Expln. (baa).

> *15. The Bombay High Court has also relied on the Memorandum Explaining the Clauses of the Finance Bill, 1991 contained in the Circular dt. 19th Dec., 1991 [(1992) 101 CTR (St) 1] of the CBDT to come to the conclusion that the Parliament intended to exclude items which were unrelated to the export turnover from the computation of deduction and while excluding such items which are unrelated to export for the purpose of s. 80HHC, Parliament has taken due note of the fact that the exporter assessee would have incurred such expenditure in earning the profits and to avoid a distorted figure of export profits, ninety per cent of the receipts like brokerage, commission, interest, rent, charges are sought to be excluded from the profits of the business. In our considered opinion, it was not necessary to refer to the Explanatory Memorandum when the language of Expln. (baa) to s. 80HHC was clear that only ninety per cent of 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 assessee could be deducted under cl. (1) of Expln. (baa) and not ninety per cent of the quantum of any of the aforesaid receipts which are allowed as expenses and therefore not included in the profits of business."*

22. In the present case, there is no record of the assessee claiming before the authorities below that the liabilities written back related to or were relatable to its export profits. Thus, the observation that

> *"if any quantum of any receipt of the nature mentioned in cl. (1) of Expln. (baa) has not been included in the profits of business of an assessee as computed under the head "Profits and gains of business or profession", ninety per cent of such quantum of the receipt cannot be deducted under Expln. (baa) to s. 80HHC."*

in *ACG Associated Capsules (supra)* squarely applies to the facts of this case. Since such amounts written back would fall within the "profits and

gains of business or profession" as computed under Section 41(1), and considering that such amounts do not have any nexus with the export activity of the assessee, keeping the view adopted by *K. Ravindranathan (supra)* in mind, they would have to be excluded from the "profits of the business" under Explanation (baa). In other words, such written back amounts would constitute "independent income" having no relation to the export profits of the assessee. They have to be excluded by virtue of Explanation (baa), to avoid distortion in the computation of export profits under Section 80HHC. This Court, therefore, finds that on this question, the ITAT's decision does not call for any interference. The third question of law framed is thus answered in favour of the Revenue.

23. For the foregoing reasons, the appeal is partly allowed in respect of questions (i) and (ii); the Revenue succeeds in respect of the third question. There shall be no order as to costs.

S. RAVINDRA BHAT
(JUDGE)

NAJMI WAZIRI
(JUDGE)

FEBRUARY 16, 2017

HIGH COURT OF DELHI
सत्यमेव जयते