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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**
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\+ **ITA 459/2015**

RIVIERA HOME FURNISHING ..... Appellant

Through: Mr. Ved Jain and Mr. Pranjal Srivastava, Advocates.

versus

ADDL. COMMISSIONER OF INCOME TAX RANGE 15 ..... Respondent

Through: Mr. Ashok Manchanda, Senior Standing counsel.

CORAM:
JUSTICE S. MURALIDHAR
JUSTICE VIBHU BAKHRU

O R D E R

% 19.11.2015

S. Muralidhar, J.:

1. The present appeal by the Appellant Assessee under Section 260A of the Income Tax Act ('Act') is directed against the impugned order dated 27th February 2015 passed by the Income Tax Appellate Tribunal ('ITAT') in ITA No.1191/Del/2012 for the Assessment Year ('AY') 2008-09.

2. **Admit.**

3. The following questions of law are framed for consideration:

> "(i) Whether in the facts and circumstances of the case, ITAT is correct in law in not allowing the exemption of Rs.28,27,224/-, on account of customer claim, ignoring the

express provision of Section 10B (4) of the Act, whereby profit of business of the undertaking are eligible for deduction.

(ii) Whether in the facts and circumstances of the case, ITAT is correct in law in not allowing the exemption of Rs.29,24,405/- on account of freight subsidy, ignoring the express provision of section l0B(4) of the Act, whereby profit of business of the undertaking are eligible for deduction.

(iii) Whether in the facts and circumstances of the case, ITAT is correct in law in not allowing the exemption of Rs.43,287/-, on account of interest on FDR, ignoring the express provision of section 10B (4) of the Act, whereby profit of business of the undertaking are eligible for deduction."

4. The Assessee is a private limited company engaged in the business of manufacture and sale of home furnishings such as rugs, bath mats, blankets etc. The Assessee set up a 100% Export Oriented Undertaking ('EOU') which was an 'eligible unit' for the purposes of deductions under Section 10B of the Act. The Assessee commenced operations on 1st October 2002. The Assessee filed its return of income for AY 2008-09 on 27th September 2008 declaring an income of Rs. 10,34,24,340. *Inter alia*, the Assessee claimed deduction in respect of the income earned from the following receipts:

(a) Deemed Export Drawback (Export Incentives) Rs. 1,22,25,214/-

(b) Customer Claims Rs. 28,27,224/-

(c) Freight Subsidy Rs. 29,24,405/-

(d) Interest on Fixed Deposit Receipts (FDRs) made for business purposes: Rs.43,287/-.

5. The return of the Assessee was picked up for scrutiny and notice under Section 143(2) was issued. The Assessing Officer ('AO') by order dated 3rd December 2010 excluded the above receipts from the computation of eligible income under Section 10B (4) of the Act. The AO was of the view that the above receipts did not fall within the expression 'profit derived' from the export of articles.

6. The appeal of the Assessee was dismissed by the Commissioner of Income Tax (Appeals) ['CIT (A)'] on 11th January 2012. The Assessee thereafter filed an appeal before the ITAT which came to be decided by the impugned order.

7. The ITAT in the impugned order agreed with the contention of the Assessee as regards the deemed export drawback forming part of the income eligible for deduction under Section 10B of the Act. However, as regards other three items, viz., customer claims, freight subsidy and interest on FDRs made for business purposes, the ITAT concurred with the view of the AO and the CIT (A). This is how the Assessee is in appeal before this Court.

8. This Court has heard the arguments of Mr. Ved Jain, learned counsel for the Assessee and Mr. Ashok Manchanda, Senior standing counsel for the Revenue.

9. The question as to what can constitute as profits and gains derived by a 100% EOU from the export of articles and computer software came for consideration before the Karnataka High Court in ***CIT v. Motorola India***

Electronics Pvt. Ltd. (2014) 46 Taxmann.com 167 (Kar).The said appeal before the Karnataka High Court was by the Revenue challenging an order passed by the ITAT which held that the interest payable on FDRs was part of the profits of the business of the undertaking and therefore includible in the income eligible for deduction Sections 10A ad 10B of the Act. There the Assessee had earned interest on the deposits lying in the EEFC account as well as interest earned on inter-corporate loans given to sister concerns out of the funds of the undertaking. There was a restriction on the Assessee in that case from making pre-payment of its external commercial borrowings ('ECB'). It could repay only to the extent of 10% of the outstanding loan in a year. This made the Assessee temporarily park the balance funds as deposits or with various sister concerns as inter corporate deposits until the date of repayment. The Assessee contended that the interest derived from the business of the industrial undertaking was eligible for exemption within the meaning of Section 10B and applied the formula under Section 10B (4) of the Act for determining the profits from exports. The Assessee's contention that the expression "profits of the business of the undertaking" in Section 10B (4) was wider than the expression "profits and gains derived by" the Assessee from a 100% EOU occurring in Section 10 B (1) was accepted by the ITAT. The ITAT noticed that unlike Section 80 HHC, where there was an express exclusion of the interest earned from the 'profits of business of undertaking', there was no similar provision as far as Sections 10A and 10B were concerned.

10. In ***CIT v. Motorola India Electronics Pvt. Ltd.*** (*supra*) reference was made to the decision of the Supreme Court in ***Pandian Chemicals Ltd. v.***

Commissioner of Income Tax (2003) 262 ITR 278 which dealt with Section 80HH and ***Liberty India v. Commissioner of Income Tax (2009) 317 ITR 218***, which interpreted Section 801B of the Act. Reference was also made to the decision of ***CIT v. Sterling Foods (1999) 237 ITR 579 (SC),*** which interpreted Section 80HH and the decision of the Madras High Court in ***CIT v. Menon Impex P Ltd. (2003) 259 ITR 403(Mad.)*** which interpreted Section 10A of the Act. The Karnataka High Court in ***CIT v. Motorola India Electronics Pvt. Ltd.*** (*supra*), after noticing the above decisions, held that "it is clear that, what is exempted is not merely the profits and gains from the export of articles but also the income from the business of the undertaking". Specific to the question of interest earned by the EOU on the FDRs placed by it and interest earned from the loans given to sister concerns, it was held that although it did not partake the character of profit and gains from the sale of an article "it is income which is derived from the consideration realized by export of articles."

11. The decision of the Karnataka High Court in ***CIT v. Motorola India Electronics Pvt. Ltd.*** (*supra*) was followed by this Court in its decision in ***CIT v. Hritnik Exports Pvt. Ltd.*** (decision dated 13th November 2014 in ITA Nos. 219 and 239 of 2014). This Court also referred to its earlier decision dated 1st September 2014 in ITA No. 438 of 2014 ***(CIT v. XLNC Fashions)***. While declining to frame a question of law in the Revenue's appeal, this Court in ***CIT v. Hritnik Exports Pvt. Ltd.*** (*supra*) quoted with approval the observations of the Special Bench of the ITAT in ***Maral Overseas Ltd. v. ACIT*** (decision dated 20th March 2012) on the interpretation of Section 10B (4) of the Act as under:

"79. Thus, sub-section (4) of section 10B stipulated that deduction under that section shall be computed by apportioning the profits of the business of the undertaking in the ratio of turnover to the total turnover. Thus, not-with-standing the fact that sub-section (1) of section 10B refers the profits and gains as are derived by a 100% EOU, yet the manner of determining such eligible profits has been statutorily defined in sub-section (4) of section 10B of the Act. As per the formula stated above, the entire profits of the business are to be taken which are multiplied by the ratio of the export turnover to the total turnover of the business. Sub-section (4) does not require an assessee to establish a direct nexus with the business of the undertaking and once an income forms part of the business of the undertaking, the same would be included in the profits of the business of the undertaking. Thus, once an income forms part of the business of the eligible undertaking, there is no further mandate in the provisions of section 10B to exclude the same from the eligible profits. The mode of determining the eligible deduction u/s 10B is similar to the provisions of section 80HHC inasmuch as both the sections mandates determination of eligible profits as per the formula contained therein. The only difference is that section 80HHC contains a further mandate in terms of Explanation (baa) for exclusion of certain income from the "profits of the business" which is, however, conspicuous by its absence in section 10B. On the basis of the aforesaid distinction, sub-section (4) of section 10A/10B of the Act is a complete code providing the mechanism for computing the "profits of the business" eligible for deduction u/s 10B of the Act. Once an income forms part of the business of the income of the eligible undertaking of the assessee, the same cannot be excluded from the eligible profits for the purpose of computing deduction u/s 10B of the Act. As per the computation made by the Assessing Officer himself, there is no dispute that both these incomes have been treated by the Assessing Officer as business income. The CBDT Circular No. 564 dated 5th July, 1990 reported in 184 ITR (St.) 137 explained the scope and ambit of section 80HHC and the mode of determination of profits derived by an assessee from the export of goods. I.T.A.T.,

> Special Bench in the case of *International Research Park Laboratories v. ACIT, 212 ITR (AT) 1*, after following the aforesaid Circular, held that straight jacket formula given in sub-section (3) has to be followed to determine the eligible deduction. The Hon'ble Supreme Court in the case of *P.R. Prabhakar; 284 ITR 584* had approved the principle laid down in the Special Bench decision in *International Research Park Laboratories v. ACIT* (*supra*). In the assessee's own case the I.T.A.T. in the preceding years, after considering the decision in the case of *Liberty India* held that provisions of section 10B are different from the provisions of section 80IA wherein no formula has been laid down for computing the eligible business profit."

12. Recently, in a decision dated 6th October 2015 in ITA NO. 392 of 2015 ***(Principal Commissioner of Income Tax v. Universal Precision Screws)***, this Court had occasion to again consider whether interest earned on fixed deposits kept by an Assessee which was eligible under Section 10B of the Act, as a condition for utilization of letter of credit and bank guarantee limits, would qualify for deduction. That question was decided in favour of the Assessee and against the Revenue. The Court held as under:

> "9. On the question of interest on the FDRs, the ITAT has referred to Section 10B (4) which states that for the purposes of Section 10B (1), the profits derived from export of articles or things or computer software "shall be the amount which bears to the profits of the business of the undertaking", the same proportion as the export turnover in respect of such articles or things or computer software bears to the total turnover of the business carried on by the undertaking.' As noted by this Court in *CIT v. Hritnik Exports Pvt. Ltd.* (decision dated 13th November, 2014 in ITA No.219 & 239 of 2014), Section 10B (4) mandates the application of the formula for determining the profits derived from exports for the purposes of Section 10B(1). In other words, the formula would read thus:

Profits derived = profits of the business x export turnover
from export of the undertaking total turnover

9A. In terms of the above formula, the question that would arise is whether the interest on the FDRs could form part of the 'profits of the business of the undertaking'. The attention of the Court has been drawn to the decision of the Karnataka High Court in *CIT v. Motorola India Electronics Pvt. Ltd. (2014) 46 Taxmann.com 167* (Kar.) which held that there was a direct nexus between the interest received from the FDRs created by a similarly placed Assessee from the amounts borrowed by it. The High Court approved the order of the ITAT in that case which held that the entire profits of the business of the undertaking should be taken into consideration while computing the eligible deduction under Section 10B of the Act by ITA 392/2015 applying the mandatory formula.

10. In the present case, the Assessee has stated that the interest on FDRs was received on "margin kept in the bank for utilization of letter of credit and bank guarantee limits". In those circumstances, the decision of the ITAT that such interest bears the requisite characteristic of business income and has nexus to the business activities of the Assessee cannot be faulted. In other words, interest earned on the FDRs would form part of the "profits of the business of the undertaking" for the purposes of computation of the profits derived from export by applying formula under Section 10B(4) of the Act"

13. Mr. Ashok Manchanda, learned Senior standing counsel for the Revenue, urged that none of the earlier decisions of the High Courts have considered the effect of Sections 80I, 801A and 801B of the Act which occur in Chapter VIA of the Act. He referred in particular to Section 80A (4) of the Act, which reads as under:

"4) Notwithstanding anything to the contrary contained in section 10A or section 10AA or section 10B or section 10BA or in any

> provisions of this Chapter under the heading "C—Deductions in respect of certain incomes", where, in the case of an assessee, any amount of profits and gains of an undertaking or unit or enterprise or eligible business is claimed and allowed as a deduction under any of those provisions for any assessment year, deduction in respect of, and to the extent of, such profits and gains shall not be allowed under any other provisions of this Act for such assessment year and shall in no case exceed the profits and gains of such undertaking or unit or enterprise or eligible business, as the case may be."

14. Mr. Manchanda's attempt was to show that Section 80A (4), which *inter alia* stated that any deduction allowable under Section 10B cannot in any case "exceed the profits and gains of such undertaking or unit or enterprise or eligible business, as the case may be" made it clear that a unit seeking deduction under Section 10B would be eligible to do so only in so far as such income was directly attributable to the business of export. Any income that might be merely incidental to the business of the undertaking, not directly related to the activity of export, would not be eligible for such deduction. He also took the Court again through the decision of the Supreme Court in ***Liberty India*** (*supra*) and submitted that the earlier decisions of this Court in ***Hritnik Exports*** (*supra*) and ***Universal Precision Screws*** (*supra*) might require to be reconsidered. When a question was posed to him as to whether the Revenue had challenge the aforementioned decisions of this Court, and of the ITAT in the present case to the extent it has allowed the plea of the Assessee as regards 'deemed export drawback', Mr. Manchanda stated that the Revenue ought to have challenged the above decisions as well as the impugned order of the ITAT in the present case and perhaps he would advise it to do so hereafter. He has also handed over a written note of

submissions, reiterating the above submissions.

15. In the considered view of the Court, the submissions made on behalf of the Revenue proceed on the basic misconception regarding the true purport of the provisions of Chapter VIA of the Act and on an incorrect understanding of Section 80A (4) of the Act. The opening words of Section 80A (4) read "Notwithstanding anything to the contrary contained in section 10A or section 10AA or section 10B or section 10BA or in any provisions of this Chapter.....". What is sought to be underscored, therefore, is that Section 80A, and the other provisions in Chapter VIA, are independent of Sections 10A and 10B of the Act. It appears that the object of Section 80A (4) was to ensure that a unit which has availed of the benefit under Section 10B will not be allowed to further claim relief under Section 80IA or 80IB read with Section 80A (4). The intention does not appear to be to deny relief under Section 10B (1) read with Section 10B (4) or to whittle down the ambit of those provisions as is sought to be suggested by Mr. Manchanda. Also, he is not right in contending that the decisions of the High Courts referred to above have not noticed the decision of the Supreme Court in ***Liberty India***. The Karnataka High Court in ***CIT v. Motorola India Electronics Pvt. Ltd.*** (*supra*) makes a reference to the said decision. That decision of the Karnataka High Court has been cited with approval by this Court in ***Hritnik Exports*** (*supra*) and ***Universal Precision Screws*** (*supra*). In ***Hritnik Exports*** (*supra*) the Court quoted with approval the observations of the Special Bench of the ITAT in ***Maral Overseas Ltd.*** (*supra*) that "Section 10A/10B of the Act is a complete code providing the mechanism for computing the 'profits of the business' eligible for deduction u/s 10B of the

Act. Once an income forms part of the business of the income of the eligible undertaking of the assessee, the same cannot be excluded from the eligible profits for the purpose of computing deduction u/s 10B of the Act."

16. This then brings us to the questions framed for consideration in the present case and the decision of the ITAT in not accepting the Assessee's plea in regard to 'customer claims' 'freight subsidy' and 'interest on fixed deposit receipts' even while it accepted the Assessee's case as regards 'deemed export drawback'.

17. The contention of the Assessee as regards customer claims was that it had received the claim of Rs. 28,27,224 from a customer for cancelling the export order. Later on the cancelled order was completed and goods were exported to another customer. The sum received as claim from the customer was non-severable from the income of the business of the undertaking. The Court fails to appreciate as to how the ITAT could have held that this transaction did not arise from the business of the export of goods. Even as regards freight subsidy, the Assessee's contention was that it had received the subsidy in respect of the business carried on and the said subsidy was part of the profit of the business of the undertaking. If the ITAT was prepared to consider the deemed export draw back as eligible for deduction then there was no justification for excluding the freight subsidy. Even as regards the interest on FDR, the Court has been shown a note of the balance sheet of the Assessee [which was placed before the AO] which clearly states that "fixed deposit receipts (including accrued interest) valuing Rs.15,05,875 are under lien with Bank of India for facilitating the letter of credit and bank

guarantee facilities." In terms of the ratio of the decisions of this Court both in ***Hritnik Exports*** (*supra*) and ***Universal Precision Screws*** (*supra*), the interest earned on such FDR ought to qualify for deduction under Section 10B of the Act.

18. Accordingly, the questions are answered in favour of the Assessee and against the Revenue. The impugned order of the ITAT to the extent it answered the said questions against the Assessee is hereby set aside.

19. The appeal is allowed in the above terms, but with no order as to costs.

S. MURALIDHAR, J

VIBHU BAKHRU, J

NOVEMBER 19, 2015
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