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

% *Date of Decision: 23.02.2023*

\+ **ITA 428/2019**

PR. COMMISSIONER OF INCOME TAX-7 ..... Appellant
Through: Mr Sanjay Kumar, Sr Standing Counsel with Ms Easha Kadian and Ms Hemlata Rawat, Advs.

versus

OM NANOTECH PVT LTD. ..... Respondent
Through: Mr Rohit Jain and Mr Aniket D. Agrawal, Advs.

CORAM:
HON'BLE MR. JUSTICE RAJIV SHAKDHER
HON'BLE MR JUSTICE VIKAS MAHAJAN

[Physical Hearing/Hybrid Hearing (as per request)]

RAJIV SHAKDHER, J. (Oral):

PREFACE

1. We have heard counsel for the parties. According to us, the matter requires consideration.

1.1 Accordingly, the appeal is admitted.

2. Counsel for the parties agree that the following question of law would arise for consideration:

(i) Whether the Income Tax Appellate Tribunal [in short, "Tribunal"] committed an error in law and on facts in importing the definition of "services" provided under the Special Economic Zones

Act, 2005 [in short, "2005 Act"] and Rule 76 of the Special Economic Zones Rules, 2006 [in short, "2006 Rules) framed thereunder, while examining the issue concerning the claim of the respondent/assessee for deduction under Section 10AA of the Income Tax Act, 1961 [in short, "1961 Act"]?

3. Since this is a pure question of law and there is no cavil regarding the facts obtaining in the matter, counsel for the parties have submitted that the matter be heard finally and disposed of.

4. The broad facts, which are required to be noticed for adjudication of this case, are the following:

4.1 The respondent/assessee has set up two units, which are located in the Noida Special Economic Zone [in short, "NSEZ"]. One of these units was into manufacturing, while the other was concerned with trading.

4.2 The manufacturing unit was set up in and about July, 2006. In this said unit, the goods manufactured, amongst others, were memory modules, flash drives and electronic chips.

4.3 The record shows that the respondent/assessee set up a trading unit in and about January 2008. The trading unit was registered on 16.01.2008.

4.4 Concededly, the trading activities of the respondent/assessee involved import of memory modules, flash drives and electronic chips [which, as noted hereinabove, was also being manufactured by it], which, ultimately, were re-exported.

4.5 In the Assessment Year (AY) in issue, i.e., AY 2010-11, the respondent/assessee declared a profit amounting to Rs.15,50,11,806/-, before adjusting deduction claimed under Section 10AA of the 1961 Act, amounting to Rs.14,81,52,422/-. The respondent/assessee, thus, pegged its

taxable income at Rs.1,71,69,860/-.

4.6 The Assessing Officer [AO] *via* the order dated 12.03.2014 disallowed the deduction claimed by the respondent/assessee under Section 10AA of the 1961 Act. The principal reason put forth by the AO for disallowing the deduction was that the deduction could be claimed only against articles manufactured in, or against the services which emanated from, the NSEZ.

5. Being aggrieved, the respondent/assessee carried the matter in an appeal to the Commissioner of Income Tax (Appeals) [in short, "CIT(A)"].

5.1 The CIT(A), *via* order dated 23.07.2014, ruled in favour of the respondent/assessee and thus, deleted the disallowance made by the AO.

6. Against the order of the CIT(A), the appellant/revenue preferred an appeal with the Tribunal.

6.1 The Tribunal, *via* the impugned order, sustained the decision of the CIT(A).

SUBMISSIONS OF COUNSEL

7. Mr Sanjay Kumar, learned senior standing counsel, has advanced the submissions in support of the stand taken by the appellant/revenue, while on behalf of the respondent/assessee, arguments have been put forth by Mr Rohit Jain.

8. Mr Kumar has, broadly, submitted that whether or not deductions ought to be granted to the respondent/assesse, is an aspect, which has to be examined by solely looking at the plain language of Section 10AA of the 1961 Act.

8.1 It is Mr Kumar's contention that since there was no inconsistency between the relevant provisions of the 2005 Act and the 1961 Act, the

Tribunal could not have taken recourse to the definition of the expression "services" contained in Section 2(z) of the 2005 Act.

8.2 In the same vein, Mr Kumar submits that the Tribunal erred in referring to the Explanation given under Rule 76 of the 2006 Rules.

9. On the other hand, Mr Jain contended that Section 10AA was introduced in the 1961 Act by virtue of the provisions made in Section 27 of the 2005 Act, read with the Second Schedule appended to the said Act.

9.1 It is, thus, Mr Jain's contention that since the expression "services" was not defined in the 1961 Act, the Tribunal was well within its powers to advert to the definition contained in Section 2(z) of the 2005 Act and accordingly, take recourse to the explanation appended to Rule 76 of the 2006 Rules.

9.2 Furthermore, Mr Jain contended that the entire purpose and object of providing deduction *qua* profits derived from trading activities was to promote exports and therefore, earn revenue for the country in foreign currency.

ANALYSIS AND REASONS

10. We have heard learned counsel for the parties and perused the record.

11. The facts which have been set forth hereinabove are not in dispute. The only issue, therefore, which arises for consideration is: whether or not the Tribunal could have taken recourse to the definition of expression "services" given in the 2005 Act and the 2006 Rules framed thereunder?

11.1 The undisputed position is that the definition of the expression "services" is not provided in the 1961 Act.

11.2 That being said, a plain reading of the language of Section 10AA of the 1961 Act would show that an assessee can claim deduction equivalent to

100% of profits and gains derived from export of services. The next logical question which, then, arises for consideration is: whether trading services of the nature which the respondent/assessee was involved in would fall within the ambit and scope of Section 10AA of the 1961 Act. For the sake of convenience, the relevant part of Section 10AA are extracted hereafter:

> *"10AA. Special provisions in respect of newly established Units in Special Economic Zones -*
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> *(1) Subject to the provisions of this section, in computing the total income of an assessee, being an entrepreneur as referred to in clause (j) of section 2 of the Special Economic Zones Act, 2005, from his Unit, who begins to manufacture or produce articles or things or provide any services during the previous year relevant to any assessment year commencing on or after the 1st day of April, 2006, a deduction of—*
>
> *(i) hundred per cent of profits and gains derived from the export, of such articles or things or from services for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which the Unit begins to manufacture or produce such articles or things or provide services, as the case may be, and fifty per cent of such profits and gains for further five assessment years and thereafter;..."*

12. We may also note that there is no dispute that Section 10AA of the 1961 Act was not brought on to the said statute by virtue of a Finance Act, but was introduced through the trigger contained in Section 27 of the 2005 Act. In this context, it would be apposite to set forth Section 27 of the 2005 Act:

> *"27. **Provisions of Income-tax Act, 1961 to apply with certain modification in relation to Developers and entrepreneurs**.—The provisions of the Income-tax Act, 1961 (43 of 1961), as in force for the time being, shall apply to, or in relation to, the Developer or entrepreneur for carrying on the 18 authorised operations in a Special Economic Zone or Unit subject to the modifications specified in the Second Schedule..."*

13. A plain reading of Section 27 of the 2005 Act would show that, clearly, the provisions of 1961 Act are made applicable to a developer or entrepreneur who carries out authorized operations in the SEZ, subject to modifications specified in the Second Schedule appended to the 2005 Act.

14. The Second Schedule of the 2005 Act, which adverts to the modifications made in the 1961 Act, concededly, refers to Section 10AA of the 1961 Act.

15. Thus, having regard to the fact that the deduction made available to an assessee under Section 10AA of the 1961 Act, which has a unit located in the SEZ, is rooted in the 2005 Act, one would, in our opinion, necessarily have to advert to the definition of expression "services" contained in the said Act. The definition of "services" is contained, as noted above, in Section 2(z) of the 2005 Act. The relevant part of the definition is set forth hereafter:

> *"**Section 2(z)** - "services" means such tradable services which,—*
> *(i) are covered under the General Agreement on Trade in Services annexed as IB to the Agreement establishing the World Trade Organisation concluded at Marrakesh on the 15th day of April, 1994;*
> *(ii) may be prescribed by the Central Government for the purposes of this Act; and (iii) earn foreign exchange;..."*

15.1 A perusal of the definition of "services", as extracted above, would show that, *inter alia,* tradable services, which are prescribed by the Central Government for the purposes of 2005 Act, are included in the definition. As to what those tradable services which are alluded to in Section 2(z)(ii) are, one gets a clue, if one was to refer to Rule 76 of the 2006 Rules. Rule 76, along with the Explanation, reads as follows:

> *"**76**. The "services" for the purposes of [clause] (z) of section 2 shall be*

> *the following, namely:—*
> *Trading, warehousing, research and development services, computer software services, including information enabled services such as back-office operations, call centers, content development or animation, data processing, engineering and design, graphic information system services, human resources services, insurance claim processing, legal data bases, medical transcription, payroll, remote maintenance, revenue accounting, support centers and web-site services, off-shore banking services, professional services (excluding legal services and accounting) rental/leasing services without operators, other business services, courier services, audio-visual services, construction and related services, distribution services (excluding retail services), educational services, environmental services, financial services, hospital services, other human health services, tourism and travel related services, recreational, cultural and sporting services, entertainment services, transport services, services auxiliary to all modes of transport, pipelines transport.*
> ***[Explanation.—The expression "Trading", for the purposes of the Second Schedule of the Act, shall mean import for the purposes of re-export.]"***
>
> [Emphasis is ours]

15.2 A plain reading of the Explanation would show that trading for the purposes of the Second Schedule of the 2005 Act means import for the purposes of re-export. Undoubtedly, the 2005 Act and Rule 76 point in the direction that the expression "services" means services which are offered by way of re-export of articles that are imported into the country. If there was any doubt as regards this aspect of the matter, the same is clarified if one were to peruse Instruction No.4 dated 24.05.2006 issued by the Government of India, Ministry of Commerce and Industry, Department of Commerce. Para 2 of the said Instruction being relevant is set forth hereafter:

> *"2. In the meantime, sourcing from domestic area may be permitted by units in the SEZs which are allowed to do trading, subject to this circular being cited and on production of an undertaking by the concerned unit that no income tax benefits will be availed by the unit for trading, except* ***in the nature of re-export of imported goods…"***
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> [Emphasis is ours]

16. The aforementioned Instruction has been adopted by the Export

Promotion Council [in short, "EPC"] via its Circular No.17 dated 29.05.2006.

16.1 Likewise, after Rule 76 was inserted in the 2006 Rules, the EPC for EOUs and SEZ units issued another Circular dated 16.11.2006. The part which is relevant for our purpose is extracated hereafter:

> *"4. Ministry of Commerce & Industry issued Notification dated 10/8/06 wherein Rule 76 of the SEZ Rules, 2006, was amended and an explanation was inserted as follows:-*
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> > ***"Explanation.- The expression "Trading", for the purposes of the Second Schedule of the Act, shall mean import for the purposes of re-export."***
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> *5. Ministry of Commerce & Industry has issued Instruction No.7/2006 dated 14/11/2006, wherein earlier Instruction No.5/2006 dated 31/5/2006 has been withdrawn and accordingly the setting up of the new trading units in the SEZs has been allowed. However, the income tax benefit to such trading units will be available only in accordance with amendments carried out in Rule 76 of the SEZ Rules, 2006, as explained above, on 10/8/2006.*
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> *Cumulative effect of all the above stated instructions is that a trading activity is allowed in the SEZ for both, the existing units as well as for the new trading units, which may be set up. These trading units are allowed to procure goods from the DTA as well.* ***However, income tax benefit, as given in the IInd Schedule of the SEZ Act, 2005, shall be available only for import for the purpose of re-export…."***
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> [Emphasis is ours]

17. Thus, having regard to the aforesaid intrinsic evidence available both in 2005 Act and Rules, we have no doubt that it was always intended that the deduction under Section 10AA of the 1961 Act will also be available *qua* those articles which, upon import to the unit located in SEZ, were thereafter re-exported.

CONCLUSION

18. The question of law as framed is answered against the

appellant/revenue and in favour of the respondent/assessee.

19. The appeal is disposed of in the aforesaid terms. The decision of the Tribunal is sustained.

20. Parties will act based on the digitally signed copy of the order.

RAJIV SHAKDHER, J

VIKAS MAHAJAN, J

FEBRUARY 23, 2023/pmc