IN THE HIGH COURT OF DELHI

ITA No.1265/2007

COMMISSIONER OF INCOME TAX (CENTRAL)

Vs

PADMINI TECHNOLOGIES LTD

Sanjay Kishan Kaul and Rajiv Shakdher, JJ

Dated: September 14, 2011

Appellant Rep by: Ms. Surushi Aggarwal
Respondent Rep by: Mr. S K Aggarwal

JUDGEMENT

Per : Rajiv Shakdher:

1. The captioned appeal pertains to assessment year 1997-1998. The revenue in this appeal has broadly raised several issues, even though the proposed question of laws are five in number. In so far as the first two issues are concerned in a connected appeal of the revenue being ITA No.1136/2007 we have already admitted the said appeal and framed questions of law which require adjudication.

It is agreed by the learned counsels for the parties that the same questions of law can be framed in the captioned appeal as well.

2. This brings to fore the third issue which pertains to the claim of deduction by the assessee under section 80 HHC of the Income Tax Act, 1961 (in short, IT Act). The revenue has proposed a question of law for our consideration even with regard to this issue.

3. In order to come to a conclusion either way, the following brief facts required to be noticed :-

3.1. The assessee runs and manages two units. Out of these two units, one unit is in the business of multimedia. In so far as the multimedia unit is concerned, the assessee has carried out exports as well. As far as the other unit is concerned, it is engaged in the manufacture of PET jars. This is a domestic unit. The assessee had claimed a deduction under section 80 HHC equivalent to Rs.1966.33 Lacs. The AO upon consideration of this aspect of the matter, came to the conclusion that in calculating the deduction under section 80 HHC, the assessee would be required to include the turnover of the entire business which would include the turnover not only of the multimedia unit but also that of the domestic unit. The Assessing Officer rejected the contention of the assessee despite the stand taken that two businesses were separate which were run through separate undertakings and involved maintenance of separate accounts including balance sheet and profit and loss

account. The Assessing Officer in these circumstances concluded that the deduction under section 80 HHC was not available to the assessee.

4. Aggrieved by the order of the Assessing Officer, an appeal was preferred to the Commissioner of Income Tax [in short, CIT(A)]. Before the CIT (A), the assessee took the same stand. The assessee followed this up by filing a revised computation of its claim in which it took into consideration only the turnover and the profits of the multimedia business. The said computation also excluded the sale proceeds realized by the assessee after 30.09.1997 in respect of which extension was not granted by the CIT (A). As per this computation, the deduction claimed by the assessee worked out to Rs.6,79,10,169/-. After a detailed consideration, the CIT (A) accepted the claim of the assessee.

4.1 The revenue being aggrieved by the order passed by CIT (A), preferred an appeal with the Income Tax Appellate Tribunal (in short, the Tribunal). The Tribunal sustained the order of the CIT (A) by following its own decision dated 10.11.2003 passed in ITA No.845/Del/1999 pertaining to Assessment Year 1995-1996 in the case of DCIT Vs. PCL Enterprises. The Tribunal noted that the said decision relied upon the Madras High Court Judgment in the case of *CIT Vs. Madras Motors Ltd. (2002) 257 ITR 60 (Mad.)* and a decision of another bench of the Tribunal in the case of Kamaljeet Vs. ITA No.1110/Del/98 dated 29.07.2003.

5. Before us, the short question is whether the contention of the revenue that in calculating the deduction under section 80 HHC, the turnover of the domestic unit ought to be included. This question had come up for consideration before the Madras High Court in the case of Madras Motors Ltd. (supra). Briefly, the facts in that case in so far as they were relevant to the issue of section 80 HHC were briefly as follows :-

5.1. The assessee was in the business of manufacturing forgings as well as the sale of motor cycles, motor cycles spare parts, television sets, etc. In so far as the forgings business was concerned, the assessee earned income both by way of exports as well as domestic sales. The assessee lodged a claim for deduction under section 80 HHC in respect of its exports qua the forgings business.

5.2 In these circumstances, the court was thus called upon to construe the true import of the word 'turnover' as used in sub-section (3)(b) of section 80 HHC. The relevant provision as extracted in the judgment reads as follows :-

“80HHC. Deduction in respect of profits retained for export business.

(3) For the purpose of sub-section (1), profits derived from the export of goods or merchandise out of India shall be, -

(a) in a case where the business carried on by the assessee consists exclusively of the export out of India of the goods or merchandise to which this section applies, the profits of the business as computed under the head 'Profits and gains of business or profession';

(b) in a case where the business carried on by the assessee does not consist exclusively of the export out of India of the goods or merchandise to which this section applies, the amount which bears to the profits of the business (as computed

under the head 'Profits and gains of business or profession') the same proportion as the export turnover bears to the total turnover of the business carried on by the assessee."

5.3 In this background, the controversy with which the court had to grapple with was limited to the meaning of the expression 'total turnover' appearing in clause (b) of sub-section (3) of section 80 HHC. The assessee contended that in calculating the proportionate profits of the business which were attributable to the export turnover, the total turnover which ought to be considered would include only the export turnover and domestic turnover relatable to the forgings business. The revenue, however, contended to the contrary. In other words, the revenue sought inclusion in the total turnover, the turnover of the entire business, which included apart from the turnover of the exports made the domestic turnover of the forgings business, the turnover achieved by the assessee vis-a-vis the sale of motor cycles, motor cycles spare parts, television sets, etc. It was obvious that if the contention of the revenue were to be accepted, then the figure in the denominator would be larger, and hence, the assessee's deduction would consequently be reduced. The court, however, after considering the submissions of both sides concluded in favour of the assessee. For our purposes, the following observations of the court being apposite are extracted hereinbelow :-

"…..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 there by that 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 F total turnover D 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 contemplate only the business regarding such goods part of which are exported and the others are not so exported. 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 outside the limits of clause (a) of sub-section (2) and that will not be permissible.

Once this situation is clear, there would be no scope of accepting the argument of the 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…..”

(emphasis is ours)

6. The judgment in the Madras Motors Ltd. (supra) was followed by two separate division benches of the Madras High Court in the case of *Commissioner of Income Tax Vs. Rathore Brothers (2002) 254 ITR 656 (Mad.) and Commissioner of Income Tax Vs. M. Gani and Co. (2008) 301 ITR 301*.

7. The learned counsel for the revenue, however, has argued to the contrary. It is the submission of Ms. Aggarwal that the issue will be governed by the judgments of the Supreme Court in the case of *IPCA Laboratory Ltd. Vs. Dy. Commissioner of Income Tax (2004) 266 ITR 521*and Simco Industries Ltd. Vs. Assessing Officer, Income Tax. The learned counsel further contends that the Tribunal did not taken into account the provisions of section 80 AB and section 80 B(5). It is the contention of Ms. Aggarwal, if the said provisions are applied then no deduction would be available to the assessee under section 80 HHC of the IT Act.

8. In our view, the contention is completely mis-conceived. The issue involved in the present case is: where an assessee runs and manages two separate units, one of which, is engaged fully or partially in earning income through exports then, in the calculation of proportionate deductible profits, would the expression 'total turnover of the business' would include only the turnover of the export business or also that of the domestic business.

9. Before we proceed further it may be relevant to note even though provisions of Section 80 HHC have been amended from time, the expression 'total turnover of the business' has not undergone a change. The expression finds mention in sub-Section (3)(1)(C) of Section 80 HHC

10. 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 80 HHC of the IT Act. This view was taken by the Madras High Court not only in Rathore Brothers (supra) but also in M.Gani & Co.(supra) which in turn followed yet another judgment of the Madras High Court in the case of *CIT Vs. Suresh B. Mehta (2007) 291 ITR 462.*

11. Ms. Aggarwal's submission that the judgment of the Supreme Court in IPCA Laboratory Ltd. (supra) and Simco Industries Ltd. (supra) would apply is according to us completely untenable. This is demonstrable from the facts obtaining in the two judgments cited before us. In IPCA Laboratory Ltd. (supra), the assessee was running an export house. For the assessment year 1996-1997, the assessee had filed a return of income declaring 'nil' income. The assessee's income before claiming deductions under Chapter VIA of the IT Act was Rs.4.39 crores. Against this income, the assessee had claimed various deductions including a deduction under section 80 HHC amounting to Rs.3.78 Crores. During the course of the assessment proceedings, it was found that the assessee was exporting goods which were manufactured by it but also those which were produced by supporting manufacturers. The assessment proceedings revealed that the profit of Rs.3.78 Crores which the assessee had claimed was earned by the assessee from exports of goods manufactured by the assessee. In so far as exports made by the assessee in respect of goods manufactured by the supporting manufacturers was concerned, the assessee had recorded a loss of Rs.6.86 Crores. It was also found that the assessee had issued certificates of disclaimer in favour of supporting manufacturers in respect of goods supplied by them for the purposes of export. It is in these circumstances that the Assessing Officer came to the conclusion that no deduction was available to the assessee on export of goods as it had as a matter of fact recorded a net loss. Therefore, the question which came up for consideration before the Supreme Court was whether the assessee was entitled to a deduction in respect of the sum of Rs.3.78 Crores without taking into account the loss of Rs.6.86 Crores recorded by the assessee in respect of the exports carried out by it qua the goods of supporting manufacturers. The Supreme Court after a detailed consideration of the matter came to the conclusion that the expression 'profits from such exports' appearing in section

80 HHC (3)(c) could only mean profits of self manufactured goods plus profit of exports of trading goods (i.e., those supplied by supporting manufacturers). The court concluded that profits had to be calculated by taking into account both exports, and that deduction was permissible under section 80 HHC (3)(1) only if there was positive profit in the export of both self manufactured goods as well as trading goods. The Supreme Court in repelling the contention of the assessee, in addition, took recourse to the provisions of section 80 AB and section 80B(5). As is evident, the facts of the case are quite different from those obtaining in the instant appeal before us.

12. Similarly, the facts obtaining in Simco Industries (supra) were also different. In that case, the assessee was engaged in the business of oil and chemicals. The Oil Division was located in Sirohi, while the Chemical Division was situated in Jodhpur. In respect of assessment years 1990-1991, it had earned profits in both Divisions. However, in earlier years the assessee had earned losses in the Oil Division. The assessee claimed deductions under section 80 HH and 80 I of the IT Act. To sustain its claim for deduction, the assessee took the stand that the Divisions should be treated separately and the losses suffered in the earlier years in the Oil Division ought not to be adjusted against the profits earned by it in the Chemical Division. The AO, however, repelled this contention and denied the deduction to the assessee under Chapter VI-A since the gross total income was nil. The Tribunal as well as the High Court affirmed the view of the Assessing Officer. It is in these circumstances, the Supreme Court was called upon to consider the question as to whether the losses suffered in the earlier years by the Oil Division of the assessee could be adjusted against the profits of the two divisions (i.e., the Chemical & Oil Division), while considering the grant of deduction under section 80 I of the Act. The Supreme Court came to the conclusion that deductions under Chapter VI-A could only be granted if the gross total income of the assessee was positive. It is in this connection that the court noticed the provisions of Section 80B(5) which defines 'gross total income' as total income computed in accordance with the provisions of the IT Act before making any deductions under Chapter VI-A. The court observed if, (as in that case) the assessee's gross total income is nil, there was no question of allowing any deduction under Chapter VI-A. The court went on to observe that in calculating the gross total income, the Assessing Officer would have to take into account the provisions of section 71 of the IT Act which provides for set off of loss from one head against income from another, and also provisions of section 72 of the IT Act which provides carry forward and set off of business losses. A reference was also made to the provisions of section 32(2) which provides for carry forward and set off of unabsorbed depreciation of a particular year. The sum and substance of the discussion of the Supreme Court in the said case was that in determining the gross total income, the business losses of earlier years of the Oil Division had to be set off before allowing any deduction under Chapter VI-A. Therefore, if as a result of this exercise, the gross total income of the assessee was nil, the assessee could not claim any deduction under Chapter VI-A. As noticed above, in our view this judgment also does not come to the aid of the revenue.

13. 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.

14. As regards, the two issues mentioned above, the following questions of law are framed :-

(i). Whether the Tribunal erred in law in allowing the entire expenditure incurred by the assessee for purchase of music titles amounting to Rs.1,12,64,618/-

(ii). Whether the Tribunal erred in law in coming to the conclusion that the assessee had not purchased an asset of enduring benefit?

(iii). Whether the provisions of section 35A of the Income Tax Act, 1961 were applicable in the facts and circumstances of the case?

(iv). Whether in the facts and circumstances of the case, the Tribunal was justified in holding that depreciation of head office ought not to be deducted from the profit of the Sahibabad unit for calculating deduction under section 80 IA of the I.T. Act.

15. Paper books be filed within eight weeks.

16. List on the regular board as per its age and seniority.