

Surendra Engineering Vs. Assistant Commissioner of Income

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Court : Income Tax Appellate Tribunal ITAT Mumbai

Decided On : Dec-12-2002

Reported in : (2003)86ITD121(Mum.)

Judge : J Bengra, Vice, R Easwar, R Rajesh

Appellant : Surendra Engineering

Respondent : Assistant Commissioner of Income

Judgement :

1. This appeal by the assessee has been referred by the Hon'ble President, ITAT, to a Special Bench because of the conflict between two orders passed by the Mumbai Bench of the ITAT in (1) ITA No.1555/Mum/1997, dt. 16th March, 2001, in the case of Jamnadas G.Hundalani, and (2) ITA No. 2561/Mum/98, dt. 30th July, 2001, in the case of Vinodiai Manilal & Co. Ltd. 2. The controversy arises this way. The assessee is a partnership firm.

It is engaged in the business of export of "trading goods". During the relevant accounting year (year ending 31st March, 1995), the turnover amounted to Rs. 3,55,02,549 which consisted only of exports. In claiming deduction of Rs. 84,87,278 under Section 80HHC(3)(b), which is the appropriate provision applicable to an assessee who exports trading goods, the assessee contended that a part of the "indirect costs" has to be attributed to the export incentives received by the assessee during the year. These incentives consisted of the following : 2.1. The assessee claimed that 10 per cent of the above viz., Rs.

1,09,567 must be attributed as indirect costs to the earning of the aforesaid export incentives and to that extent, the indirect expenses debited in the P&L a/c should be reduced for the purpose of computing the deduction in accordance with the formula laid down in Section 80HHC(3)(b).

2.2. The significance of the claim made by the assessee may be briefly explained. Under the above-mentioned section, an exporter of trading goods is entitled to the deduction in respect of the profits derived from such export which shall be the export turnover as reduced by the direct costs and the indirect costs attributable to such export. The smaller the figure of direct and indirect costs, the larger will be the profits derived from the export and consequently larger will be the deduction. By attributing a part of the indirect costs to the export incentives, the assessee seeks to reduce the indirect costs attributable to the export of trading goods so that it will be left with a larger amount of export profits, which it can deduct from its gross total income. The attempt of the IT authorities is to prevent this by holding that no part of the indirect costs can be attributed to the export incentives. This in brief is the bone of contention.

2.3. The following example will clarify the position (figures assumed) : $40,000 + 90\%$ of Export incentives [Proviso to s. 80HHC(3)] $\times$ Export turnover/Total turnover
Proportionate indirect costs (Rs. 10,000 minus 10 % of export incentives i.e., 6,000) From the above comparative working, it may be seen that if the assessee's contention regarding the indirect costs to be deducted is accepted the deduction under Section 80HHC comes to Rs. 1 lakh, whereas if the AO's working is accepted, the deduction comes to Rs. 94,000 only. This, in a nutshell, explains the significance of the rival positions. In the present case, the AO has computed the deduction at Rs. 83,77,711. The difference is Rs. 1,09,567, which is solely due to the fact that the assessee reduced the indirect costs by 10 per cent of the export incentives, which comes to Rs. 1,09,567.

3. In support of the claim, the learned counsel for the assessee argues like this. Under Section 80HHC(3)(b) only indirect costs which are "attributable to such export" can be deducted from the export turnover.

Export incentives are not export of goods. They cannot be considered as "export turnover" as defined in Clause (b) of the Explanation below Sub-section (4B), because they do not represent any "sale proceeds".

They cannot be considered as part of the "total turnover" also, within the meaning of Clause (ba) of the said Explanation, as they have been specifically omitted from the definition by the proviso thereto.

Therefore, export incentives cannot, for the purposes of the deduction under Section 80HHC, be considered as "export turnover". Further, Clause (baa)(1) of the said Explanation specifically excludes 90 per cent of the "non-export" receipts, which should include export incentives also, from the "profits of the business". Thus, not only are the export incentives excluded from export turnover, but they are also excluded from the profits of the business to the extent of 90 per cent.

If that is so, it would be irrational to consider the indirect costs attributable to export incentives as part of the indirect costs "attributable to such export", meaning "export turnover". Though "indirect costs" are defined broadly as costs other than direct costs, one should bear in mind the context and the setting of the definition and should interpret the same keeping in view the basic condition of 'Sub-section (3)(b) that indirect costs should be 'attributable to such export' As regards the basis for ascribing 10 per cent of the export incentives as indirect costs attributable to them, the argument was that this is the percentage attributed by the legislature itself in Clause (baa) of the Explanation below Sub-section (4B) while excluding the export incentives from the "profits of the business" and also in the proviso to Sub-section (3). Attention was also invited to the Memorandum explaining the provisions of the Finance (No. 2) Act, 1991, and the Circular No. 621, dt. 19th Dec., 1991, issued to explain the provisions of the Finance (No. 2) Act, 1991, to show that the legislature itself regards 10 per cent of the common expenses as attributable to receipts which have no connection with the exports and have, therefore, excluded only 90 per cent (and not the entire) of such receipts from the "profits of the business" and, therefore, irrespective of the actual amount of the indirect costs attributable to the export incentives, only 10 per cent may be taken to be so. Our attention was also invited to the following orders of the

Mumbai Benches of the Tribunal which have taken a view in favour of the assessee's claim; 4. The learned CIT (Departmental Representative) put forth his case like this. It is a matter of policy that the Government have thought it fit to exclude only 90 per cent of the receipts by way of commission, interest, rent, etc. and receipts of similar nature from the "profits of the business" as per Expln. (baa) to Sub-section (4B) instead of 100 per cent of such receipts and from this it cannot be inferred that the legislature has assumed that 10 per cent of such receipts has to be treated as costs or expenses to earn such receipts. That Explanation was inserted for an entirely different purpose and is not relevant for the purpose of interpreting Clause (b) of Sub-section (3). In fact, neither the Explanation nor the Memorandum explaining the provisions of the relevant Finance Bill nor even the circular issued by the CBDT has referred to export incentives and, therefore, it cannot be assumed that 10 per cent of the export incentives should be considered as costs or expenses incurred to earn them. Further, the export incentives are not treated either as "export turnover" or as part of "total turnover" or as part of the "Export profits". The definition of "indirect costs" as per Expln. (e) below Sub-section (3) does not exclude such costs incurred for earning export incentives. Therefore, there is no justification for excluding indirect costs, if any, incurred for earning export incentives. The assessee in the present case is a 100 per cent exporter and, therefore, the entire expenses, both direct and indirect, can be only in respect of the export turnover or activity.

Even factually, considering the nature of the export incentives received by the 'assessee, it is impossible to conceive of any costs or expenses incurred for the purpose of earning them. Section 80HHC is a special deduction and, therefore, there is no room for any inference or intendment, as held by the Delhi High Court in CIT v. Sir Sobha Singh Pulic Charitable Trust (2001) 250 JTR 475 (Del). At any rate, the actual incurring of the expenditure to earn the export incentives is a matter of evidence and proof which is lacking in the present' case. So ran the argument of the learned CIT's Departmental Representative.

5. In his reply, the learned counsel for the assessee clarified that irrespective of the factual position, the legislature has assumed that 10 per cent of certain receipts will have to be incurred for earning them and have, therefore, thought, it fit

only to exclude 90 per cent of those receipts from the purview of "profits of the business" and even while granting a further deduction as per the proviso to Sub-section (3) only this 90 per cent is taken as the basis and when all through the provisions the assumption of the legislature runs, there is no reason why a similar assumption cannot be validly made while interpreting Clause (b) of Sub-section (3) r/w Clause (e) of the Explanation below the sub-section. He contended that this assumption is the basis for the claim of the assessee.

6. We have carefully considered the issue. Section 80HHC makes provision for the deduction of the export profits subject to certain conditions. The section has been amended several times since its introduction. Sub-section (3) was substituted w.e.f. 1st April, 1992, by the Finance (No. 2) Act, 1991. It made a distinction between export of goods manufactured or processed by the assessee and export of trading goods and also provided for deduction in the case of an assessee who export both types of goods. Clause (b) provides for deduction in the case of an assessee who exports trading goods. It is as follows : "(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." "Provided that the profits computed under Clause (a) or Clause (b) or Clause (c) of this subsection shall be further increased by the amount which bears to ninety per cent of any sum referred to in Clause (iiia) (not being profits on sale of a licence acquired from any other person), and Clause (iiib) and (iiic) of Section 28, the same proportion as the export turnover bears to the total turnover of the business carried on by the assessee." Direct and indirect costs are defined in cls. (d) and (e), respectively, of the Explanation below the sub-section: "(d) 'direct costs' means costs directly attributable to the trading goods exported out of India including the purchase price of such goods; (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;" We may also reproduce Clause (baa) of the Explanation below Sub-section (4B) which was also introduced simultaneously with the present Sub-section (3) by the Finance (No. 2) Act, 1991, w.e.f. 1st April, 1992 : "(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) and (iiic) 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;" While introducing the present Sub-section (3), the Memorandum explaining the provisions of the Finance (No. 2) Bill, 1991, stated as follows : "Under the existing provisions of Sub-section (3) of Section 80HHC of the IT Act, profit derived from the export of goods is computed in the following manner ; Profits of the business x Export turnover/Total turnover xxx xxx The existing formula may also give a distorted figure of export profits when receipts like interest, commission, etc. which do not have any element of turnover are included in the P&L a/c.

It is, therefore, proposed to clarify that "profits of the business" for the purpose of Section 80HHC will not include receipts by way of brokerage, commission, interest, rent, charges or any other receipt of a similar nature. As some expenditure might be incurred in earning these incomes which in the generality of cases is part of common expenses, it is proper to provide ad hoc 10 per cent deduction from such incomes to account for these expenses".

7. The Circular No. 621, dt. 19th Dec., 1991 [(1992) 195 ITR (St) 154 @ 178], in paras. 32.10 and 32.11, expresses the same view in identical language.

8. The amendment made by substituting Sub-section (3) has introduced a different basis for allowing deduction in respect of that portion of the "profits and gains of the business" as per the assessment which is proportionate to the ratio which the export turnover bears to the total turnover, after the amendment different bases were provided depending on whether the assessee is an exporter of manufacturing goods exclusively or of trading goods exclusively or a combination of both.

We are concerned with an assessee who undisputedly is an exporter of "trading goods" exclusively and, therefore, Clause (b) of Sub-section (3) applies. In the case of such an exporter the export profits shall be the export turnover in respect of such trading goods as reduced by (1) the direct costs, and (2) the indirect costs. Both these costs should, however, be "attributable to such export", which means

the export of trading goods. By using these words in Clause (b) of Sub-section (3) and thereby introducing a condition that both the direct and the indirect costs must be attributable to the export of trading goods, the legislature has manifested an intention that any costs which are attributable to receipts other than the export turnover of trading goods must be left out of reckoning at the threshold itself.

This condition thus forms the substratum or bedrock of the computation of the export profits. Therefore, if any part of the direct or indirect costs are attributable not to the export of the trading goods in other words, the export turnover--that part should be left out of consideration. The definition of "direct costs" is a little articulate in the sense that it expressly says that these are "costs directly attributable to the trading goods exported out of India including the purchase price of such goods". The definition of "indirect costs" is, however, not so articulate and merely says that these are "costs, not being direct costs, allocated in the ratio of the export turnover in respect of trading goods to the total turnover". It is thus couched in a somewhat negative form, contrasted with "direct costs". That is to say, all costs which are not direct costs are to be considered as indirect costs. If any assessee is engaged in both export of trading goods and local sales of trading goods, there shall be an allocation on the basis mentioned in the definition. But the definition also implies that only those costs are to be considered as indirect costs which are attributable to the trading goods exported out of India, for the purposes of Clause (b) of Sub-section (3). When the direct costs, by definition, are those costs attributable to the trading goods exported out of India, including the purchase price of such goods, and when the indirect costs are defined as costs not being direct costs, it follows by implication that the indirect costs should also be attributable to the trading goods exported out of India, including the purchase price of such goods. The basic idea which runs through Clause (b) of the sub-section and Clauses (d) and (e) of the Explanation below the sub-section is that the indirect costs should be attributable to the export turnover in respect of the trading goods. As a corollary, it follows that indirect costs which are not attributable to the export turnover of trading goods, are not taken in by these provisions. It, therefore, follows that any indirect costs which can reasonably be attributed to receipts other than the export turnover of trading goods will have to be left out of consideration at the threshold itself.

9. The conclusion we have reached above is purely on the interpretation of the language employed in Clause (b) of Sub-section (3) and Clauses (d) and (e) of the Explanation below the sub-section. There are other reasons to think that even the legislature took note of the possibility of a part of the expenses incurred by an assessee being referable to receipts other than the receipts by way of export turnover. We are referring to Clause (baa) of the Explanation below Sub-section (4B) which was also introduced by the Finance (No. 2) Act, 1991, w.e.f. 1st April, 1992. While explaining the amendment, the Memorandum, the relevant portion of which has already been extracted by us, recognized that some expenditure might be incurred in earning the receipts by way of brokerage, commission, interest, rent, charges or any other receipt of similar nature and that such expenditure is generally part of common expenses. In recognition of this position, it was stated that it would be proper to provide ad hoc 10 per cent deduction from such incomes to account for these expenses. Accordingly, Clause (baa) of the Expln.

below Sub-section (4B) excluded 90 per cent of such receipts from the profits of the business, because these receipts had nothing to do with the exports. It did not exclude the entire receipts. Similarly, when it came to the proviso to Sub-section (3), by which the deduction for export profits was to be increased by the export incentives, the legislature restricted the increase to 90 per cent of the export incentives. Here, the entire 90 per cent of the export incentives was not given as additional deduction but the same was restricted to the proportion which the export turnover bears to the total turnover of the business. By restricting the additional deduction under the proviso to 90 per cent of the export incentives, the legislature impliedly recognised that 10 per cent of the export incentives would have been incurred by the assessee as expenses to earn the same. It is pertinent to note that both in Expln. (baa) below Sub-section (4B) and in the proviso to Sub-section (3), the export incentives of a particular type have been specifically mentioned. Such incentives are those referred to in Section 28(iia), (iib) and (iic) of the Act Expln. (baa), when it also referred to "any other receipt of a similar nature included in such profits" implies, in our opinion, a reference to receipts which are not in anyway connected with the export profits. It has to be borne in mind that the object of introducing Expln. (baa) below Sub-section (4B) is that the existing formula gave a distorted figure of export profits when receipts which do not have an

element of turnover were included in the P&L a/c. Please see observations of the Bombay High Court in CIT v. K.K. Doshi & Co. (2000) 245 ITR 849 at 852 (Bom).

Therefore, all receipts which do not have an element of turnover have to be excluded from the profits of the business for purposes of computing the export profits. The words "export turnover" have been defined in Clause (b) of the Explanation below Sub-section (4B) to mean the sale proceeds received in or brought into India by the assessee in convertible foreign exchange of any goods or merchandise which are exported out of India, excluding freight and insurance attributable to the transport of the goods. All these provisions strengthen the view that the legislature itself thought that 10 per cent of such receipts must be assumed to be expenses incurred for earning the same. Exclusion of such receipts from the export business or export turnover or export profits lends credibility to the contention of the assessee that the entire indirect costs cannot be attributed to export of trading goods and a part thereof, which must be taken at 10 per cent of such receipts, because that is the standard applied by the legislature, should be attributed to activities giving rise to receipts other than receipts by way of export of trading goods.

10. The learned CIT (Departmental Representative) is no doubt right in his contention that Expln. (baa) below Sub-section (4B) has no relevance to the computation of the deduction allowable under Clause (b) of Sub-section (3), but at the same time, it cannot be looked at as an aid to fathom the mind of the legislature. It shows that not all indirect costs are referable only to the export of trading goods and a part thereof may be reasonably considered to be attributable to other activities or receipts.

11. One important point which the learned CIT (Departmental Representative) raised was that there is no evidence or proof in the present case to show that a part of the indirect costs incurred by the assessee is attributable to the earning of the export incentives. It must be clarified at this juncture that in the present case the claim of the assessee has been put forth only on the basis that even the legislature has recognised the position that 10 per cent of the receipts arising out of activities other than export of trading goods may be considered as expenditure

for earning them. In fact the learned counsel for the assessee fairly stated that in a given case, such expenditure may be either less or more than the above percentage and it can be assumed that the legislature did not want to undertake a minute examination of such expenses to find out how much can be attributed to activities other than export of trading goods and thought in their wisdom, that a flat-rate or ad hoc percentage may be considered as having been incurred in connection with such receipts. This assumption, in our opinion, is not without basis. It may be recalled that in CIT v. Indian Bank Ltd. (1956) 56 ITR 77 (SC), the Supreme Court observed, with reference to Section 10(2)(xv) of the 1922 Act, which allowed deduction in respect of expenses wholly and exclusively laid out for the purpose of the business, that it is not necessary to find out whether such expenses have produced or will produce taxable income for the reason that Parliament might have assumed that most types of expenditure would directly or indirectly produce taxable income and it is not worth the administrative effort involved to go further and trace expenditure to some taxable income. An assumption in the present case can very well be made to the effect that the Parliament considers that 10 per cent of the receipts unconnected with the export activity would have been incurred by the assessee as expenditure to earn the same. It is possible to justify the assessee's claim on this basis also.

12. The learned CIT(A) has taken the view that as per the definition of "indirect costs" in Expln. (e) below Sub-section (3), except the allocation between export turnover in respect of trading goods to the total turnover in a case where the assessee has both exports and local sales, no other apportionment is contemplated. Therefore, according to him the assessee's attempt to allocate or apportion a part of the indirect costs to the export incentives must fail. With respect, this view appears to us to overlook the import of the words "attributable to such export" appearing in Clause (b) of Sub-section (3). The definition of "indirect costs" must be governed or controlled by the words "attributable to such export" appearing in Clause (b) of Sub-section (3) since the attempt is to find out, in a reasonable manner, the profits derived from the export of trading goods, and, therefore, whatever expenditure is not relevant or cannot be reasonably stated to have been incurred in connection with the exports or can be reasonably said to have been incurred in connection with other activities or receipts, will have to be

excluded. The so-called definition of "indirect costs" must receive a reasonable interpretation having regard to the language used in Clause (b) of Sub-section (3); it cannot certainly override the main clause whose object and purpose it is to subserve. If indirect costs are interpreted to mean also those costs which are not attributable to the export of trading goods, that would be clearly contrary to the express language used in Clause (b) of Sub-section (3), which is not permissible. Again, it is no doubt true, as held by the CIT(A), that the circular issued by the Board (cited supra) does not lay down that the indirect costs of export turnover are required to be reduced by 10 per cent. But, it is equally true that the circular, which explains the definition of "profits of the business" as per Clause (baa) of the Explanation below Sub-section (4B), takes note of the possibility that some expenses, which it fixes at 10 per cent ad hoc, are necessary to earn such income. The assessee is only trying to take inspiration from that logic and wants the same to be extended to the interpretation of Clause (b) of Sub-section (3). In our opinion, the assessee can be permitted to do so.

13. The learned CIT (Departmental Representative) has referred to three orders of the Mumbai Benches of the Tribunal in which a view in favour of the Department was taken. They are : In our opinion, for the reasons given by us, the view expressed in favour of the assesseees in the orders of the Tribunal referred to in para 3 appeals to us more than the other view.

14. Ground No. 2 is against the disallowance of Rs. 10,000 under postage, telegram, telephone and telex expenses. This ground will be decided by the Division Bench.

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