Lalsons Enterprises Vs. Dcit

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SooperKanoon Citation : sooperkanoon.com/72985

Court : Income Tax Appellate Tribunal ITAT Delhi

Decided On : Feb-25-2004

Reported in : (2004)89ITD25(Delhi)

Judge : R Easwar, B Kothari, C S T.N.

Appellant : Lalsons Enterprises

Respondent : Dcit

Judgement :

1. The following question have been referred to the Special Bench by the Hon'ble President of the Tribunal Under Sec. 255(3) of the Income Tax Act, 1961 : (i) "Whether the negative profit (loss) from the business or export computed in accordance with clause (a), (b) or (c) or sub section (3) of section 80-HHC of the Income-tax Act should be ignored or it should be adjusted/set off against export profits computed under any of the aforesaid clauses for the purpose of computing deductions under section 80 HHC(1) of the Income-tax Act ?" (ii) "Whether the proviso to section 80-HHC(3) can be applied in a case where the export profit computed as per clause (a), (b) or (c) of sub-section (3) or aggregate hereof is a negative profit (loss) and if so whether the said negative profit (loss) has to be adjusted/set off against the amount of deduction allowable under the proviso to section 80-HHC(3) or the loss computed under all or any of the clauses (a), (b) or (c) of section 80-HHC(3) has to be ignored and deduction under section 80-HHC is required to be allowed on the amounts computed under proviso to section 80-HHC(3) of the Income-tax Act?" (iii) "Whether 90 per cent of the gross interest

received by the assessee shall be reduced from the profit and gains of the business or profession to determine profits of the business as given in Explanation (baa) below sub-section 4(b) of section 80-HHC of the Income-tax Act in order to compute the deduction under section 80-HHC of the Income-tax Act or only 90 per cent of net receipt of the interest after allowing a set off of interest paid against the interest receipt?" 2. All the three question involve the interpretation of sec 80-HHC, which has become perhaps the most debated section of the Act letely.

The section has been amended many times handsome of the amendments were purportedly made to clarify or rationalise or streamline the provision but that has not stopped the rival parties - the taxpayer and the Revenue - from raising disputes on the basis of the interpretation of the section, each to suit their own purpose. Many of the issues reached the Tribunal all over the country and many orders were passed thereon by different Benches. It was found that there was a read for uniformity of views with regard to some of the important provisions of the section. Accordingly one of the benches in Delhi made a reference to the Hon'ble President with a request to constitute a Special Bench to resolve the issues and hence the present reference.

3. We have had the benefit of well-prepared arguments from both the sides - Mr. Sapra and Mr. Ajay Vohra, advocate, Mr. Rajan Vora, Chartered accountant from Bombay and Mr. Rahul Mitra, Chartered accountant representing M/s. Price Waterhouse of Calcutta, for the assessee and interveners and Mr. Prahlad Singh, Mr. Salil Gupta, learned CIT(DRs) and Mr. S.K. Jain, the learned Senior Departmental Representative representing the income-tax department. We place on record our appreciation for the assistance rendered by them.

4. Sec. 80-HHC, to the extent it is relevant for the questions referred to us, is reproduced below : (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 on 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 as 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 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, by 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 : Provided that the profits computed under clause (a) or clause (b) or clause (c) of this sub-section shall be further increased by the amount which bears to ninety per cent of any sum referred t in clause (iiia) not being profits on sale of a licence acquired from any other person), and clauses (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 Explanation - (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 ; " 5. We may now take up the questions referred to us for decision, seriatim. As regards the first question, it was agreed before us by both the sides that the reference therein to clauses (a) and (b) of sub-section (3) is not apposite, since the question of adjustment of the losses against the profits under clauses (a) and (b) cannot possibly arise and can arise only under clause (c) because it contains two sub-clause which provide for the determination of the export profits in respect of an assessee who exports both manufactured goods and traded goods. It is only in his case, where clause (c) applies, that the question of adjusting the loss in of these two export activities against the profit arising in the other than arise.

Therefore, Mr. Prahlad Singh, the learned CIT(DR) suggested the reframing of the first question as under, which was accepted by the assessee/ Interveners as

representing the correct poser : (i) "Whether the negative profit (loss) from the business of export computed in accordance with sub-clause (i) or (ii) of clause (c) of sub-section (3) of section 80-HHC should be ignored or it should be adjusted/set off against export profits computed under the other sub clause [of clause (c)] for the purpose of computing deduction under section 80-HHC(1) of the Income Tax Act?" 6. We may add that in question (iii) the reference to sub-section 4(b) should actually be to sub-section (4B). The question may be read as amended accordingly.

7. There are two direct judgments on the above question - on of the Bombay High Court in IPCA Laboratories Vs. Dy. CIT, 2003-TAXINDIAONLINE-58-HC-MUM-IT, (251 ITR 401) and the other of the Kerala High Court in CIT Vs. Smt. T.C. Usha (132 Taxman 297). In the Bombay judgment it has been held that the loss incurred by the assessee in the export of trading goods shall be set off or adjusted against the profits earned in the export of manufactured goods under clause (c) because of the conjunction "and" between the two sub-clause which was suggestive of an aggregation of the two. It was further held that through the word "profit" in sub-section (1) cannot include loss the word "profit" occurring in sub-section (3) will include negative profit of loss. sub-section (3) was held to be a machinery provision merely in aid of sub-section (1). The word "profit" occurring in sub-section (3), it was held, cannot be construed in the same manner as one would construe the words "profit" and gains" which would include loses or negative profits. In the Kerala Judgment the assessee earned profits in the export of manufactured goods but suffered losses in the export of trading goods. It appears from paragraph 3 of the judgment (as reported in Taxman) that the judgment of the Bombay High Court in IPCA Laboratories (supra) was cited before the Kerala High Court on behalf of the Department. There dos not appear to be any discussion of the judgment. But after discussing he issue elaborately the Kerala High court held the view that the words "profits of the business" or "adjusted profits of the business" occurring in sub-section 3 must be read with Explanation (baa) below the section which defines the words "profit of the business" for the purposes of the section to mean profits and gains computed under the head" profits and gains of the business of profession" and so read they have to be computed only in accordance with the provisions of secs. 28 to 43D or the Act which fall under

Chapter IV-D of the Act, and that sections 70 and 71, which provide for adjustment of the loss under one source or head against the profits from another source or head respectively, do not fall under the computation provisions relating to business income and therefore the mutual adjustment of the loss or profit from the export of trading goods against the loss or profit from the export of man manufactured goods cannot be permitted. It was noted that sec. 80-HHC is a self-contained provision by itself - a view which the Bombay High Court also took in IPCA Laboratories - and therefore the benefit available under sub-section (1) thereof has to be worked out in accordance with the subject to the provisions of that section only. It was further held that the legislative intention was clearly to exclude the provisions of sections 70 and 71 of the Act while computing the profits and gains of business under Explanation (baa), for the computation of the profits in such a manner would arise only for arriving at the total income or gross total income and since clause (c) of sub-section (3) of sec.

80-HHC does not refer to total income or gross total income there can be no adjustment or set-off of the result of the export of trading goods and the export of the manufactured goods against each other.

8. Thus there are two divergent views taken by two High Courts. No other decision of any High Court where this precise question was considered was brought to our notice. The argument predictably was that if two reasonable views are plausible on the interpretation of a section, the view that favours the assessee should be adopted, based on the judgment of the Supreme Court in CIT Vs. Vegetable Products (88 ITR 192). We would however prefer to follow the judgment of the Bombay High Court for two reason. Firstly, the Bombay High Court has reached its conclusion on the basis of the conjunction "and" occurring between the two sub-clauses of clause (c). This point does not appear to have been argued before the Kerala High Court. Secondly, the principle of adjusting the loss fro one source under the head "business" against the profits of another business is embedded in sec. 28 itself and sec. 70 merely accords statutory recognition to this principals. When income is computed under sec. 28, the results of each business carried on by the assessee is computed separately and ultimately the results have to be aggregated which involves the adjustment of losses from one business against the

profits of another business. The law is stated as follows at page 2982 of Vol. 2 of Sampath Lyengar's treatise on income-tax law, (4th Edition revised by Hon'ble Justice S. Ranganathan) : "3. Inter-head adjustments : - This section deals with intra-head adjustments, i.e., adjustments as between several sources of income under one and the same head of income in respect of the same previous year. Under the 1922 Act, there was not corresponding provision, though the principle underlying this set off was held to be in plicit in the manner of computation of the income under a head and of the total income. In Rajapalayam Mills Ltd. Vs. CIT (1978) (115 ITR 771) (SC),the Supreme Court reiterated this position and held that though the profits of each distinct business carried on by the assessee have to be computed separately in accordance with the provisions of section 10 of the 1922 Act, the tax is chargeable under that section not separately on the profits of each business but on the aggregate of the profits of all the businesses carried on by the assessee. For instance, where the assessee carried son several businesses, he was held entitled to set off losses incurred in one business against profits in another. The resultant negative figure may be due to the allowances permitted under a particular head in the computation of income.

Section 70 incorporates the principle of the above decisions and fills up a lacuna that existed under the old Act. By virtue of the section, loss arising from any source of income under any particular head can be set off against profit from another source under the same head of income After the enactment of this section, it is unnecessary to consider whether such "set off" clause be effected even otherwise say, on the language of section 28 itself." 9. The same view has been expressed at page 870 of Vol. I of Kanga and Palkhivala's "The Law and Practice of Income Tax." 8th Edn.

"Sec. 70. Sec-off of loss against income under same head. - Export in the three cases noted below, if the net result in respect of any source under any head is a loss, that loss may be set off under s.

70 against income from another source under the same head. Income under each head in computed by lumping together the income from various sources which fall under the same head. There was not such express provision in the 1922 Act for

setting of losses against income under the same head, but the principle was held to be implicit in that Act. For instance, losses in a business were set off against profits in another business or against professional earnings under the old s. 10 itself which correspond to s. 28 of the Act." [A large number of cases have been quoted in the footnote of the page 870 cited above.] 10. A large number of authorities are collected at footnote in support of the author's view that the principle under the set off was implicit in the manner of computation of income under a particular head. The concept of adjustment of losses from one business against the profits of another business is thus inbuilt in the definition of "profits of the business" in Explanation (baa). This aspect of the matter, in our most humble opinion, does to also appear to have been argued before the Kerala High Court. By the use of the conjunction "and between the two sub-clause in clause (c) of the sub-section, this principle has been recognized in the clause. For these reasons, we respectfully bellow the judgment of the Bombay High Court in IPCA Laboratories (supra) and hold that the results of the export of trading goods and the export of manufactured goods have to be aggregated and if these is loss in one and profits in the other, the loss has to be set off against the profits under clause (c) of sec. 80-HHC(3).

11. Mr. Rahul Mitra, the learned representative for Exide Industries (intervener from Calcutta), put forth a forceful contention. He cited the circular of the Board reported in 190 ITR (St.) 270 @ 299, which explains the provisions of finance (no. 2) Bill. 1991 by which the present sub-section (3) was introduced into sec. 80-HHC with effect from 1-4-1992. The circular in paragraph 18, explain the object behind the new sub-section in the following words : "Under the existing provisions of sub-section (3) of section 80-HHC of the Income-tax Act, profits derived from the export of goods is computed in the following manner : The application of this formula has given rise to some misuse. Many cases have come to notice where persons, who are not chargeable to income-tax, transfer their export turnover to business houses merely by endorsement of letter of credit received by them. Business houses which "but" hit export turnover get the benefit of deduction under section 80HHC without any physical export of goods.

The tax concession under section 80HHC is intended to compensate an exporter for the comparative disadvantage passed by him in the international market. With a view to ensuring that the tax concession is not misused, it is proposed to amend sub-section (3) of section 80HHC of the Income -tax Act." 12. The contention of Mr. Mitra, based on the above circular, is that the amendment was brought only to prevent the misuse of getting the deduction for export of trading goods by buying the turnover from others and applying the Heydon's rule of interpretation, as applied in many cases and recently by the Supreme Court in Quarry Owners' Association Vs. State of Bihar & Other [(2000) 8 SCC 655], even for the purpose of clause (c) of the sub-section the principle of aggregation should not be applied. Detailed written submissions were made in this behalf to explain the contention with example. It would be better to reproduce this part of the written submissions to appreciate the point sought to be made.

13. "Now, the question that arises, is how was the concession under section 80HHC of the Act misused prior to the amendments brought about in sub-section (3) of section 80HHC of the Act, which the Parliament wanted to abolish? The misuse can be explained with the help of the following example : Export turnover = Rs. 300 (Manufactured export Rs. 200 and Trading export Rs. 100) Costs incurred with respect to trading export = Exports = Rs. 150 (thus trading loss = Rs. 50 (Rs. 150-Rs. 100) total profits of the assessee's business = Rs. 1000 (manufactured profits Rs. 1050 - trading loss Rs. 50] Computation of deduction prior to amendment of section 80HHC (upto assessment years 1991-92) (Profits from business) x (Export turnover) / (total turnover) = [1000 x 300 / 3000] = Rs. 100 Under the said manner of computation the assessee was able to claim deduction with reference to even a portion of the domestic profits, namely, profits derived on sale of the products in the domestic market, on the strength of the export turnover relating to trading goods, though the trading exports actually resulted in a loss.

Had the assessee been allowed deduction only with respect to the export of the products actually manufactured by it, without taking into account the result, namely both the profits and the turnover, of the trading business, then, the quantum of deduction under section 80HHC of the Act would have been computed as follows [(Profits from manufactured business) X (Export turnover of manufacturing

business) / (Total turnover of manufacturing business)] = 1050x200/2900] = Rs. 72.41. [Rs. 3000- Rs. 100] Thus, the assessee got an advantage to the tune of Rs. 27.59 (Rs. 100 - Rs. 72.41) under section 80HHC of the Act, on the strength of exporting trading goods wroth Rs. 300 even though the assessee had actually incurred a loss of Rs. 50 on account of its trading business. In other words, the assessee was able to claim benefits of deduction under section 80HHC of the Act merely by buying in trading loss, which was conceived of by the legislature as a misuse of the incentives granted by the said section. With a view to stop the side misuse, the formula amended with effect from the assessment year 1992-93 by segregating trading exports and manufactured exports for the purposes of section 80HHC of the Act.

Computation of deduction subsequent to amendment of section 80HHC (on or after assessment year 1992-93) (i) Profits derived from export of manufactured goods = (Adjusted profits of the business) x (Adjusted export turnover) / (Adjusted export turnover)/Adjusted total turnover) = (1050 x 20 / 2900] = Rs/ 72.41, namely as discussed earlier.

(ii) Profits derived from export of trading goods = (trading exports - Trading expenses] = Rs. 50 (loss) Now, prior to the amendment of section 80HHC (3) of the Act, the assessee was able to use the mischief of the said section to its advantage, to the tune of Rs. 27.59 [Rs. 100 - Rs. 72.41]. It was this mischief that the legislature wanted to remove by segregating trading exports and manufactured exports, such that only if an assessee derived profits on export of manufactured goods, being bonafide transactions, then it would be entitled to the benefit so the said section. In the event the assessee also derived a positive income or profits from export of trading goods, then the said profits would be added to the profits derived from the export of manufactured goods for the purposes of computing the total quantum of deduction under section 80HHC of the Act. However, if the trading exports actually result in a loss, as has been in the instant case, then such loss cannot be reduced or offset from the profits derived from the export of manufactured goods, since the profits derived on export of manufactured goods simplicities were always covered by the exemption envisaged in section 80HHC of the Act and the same were never the subject matter of the mischief of the pre-

amended section 80HHC(3) of the Act, which the legislature wanted to remove by making the necessary amendments to the said section with effect from the assessment year 1992-93.

Therefore, any attempt to set off the loss incurred on the export of trading goods against the profits derived on the export of manufactured goods, would travel or traverse beyond the legislative intent of object in making the amendments made to section 80HHC (3) of the Act by the finance (no. 2) Act, 1991, namely to remove the misuse of the formula provided in the pre-amended section, since the profits derived on export of manufactured goods never fell within the mischief of defect embedded in section 80HHC(3) of the Act.

Thus, such an attempt would not subserve the legislative intent of object in introducing the amendments to section 80HHC(3) of the Act as discussed above." Mr. Mitra further contended that the memorandum explaining the provisions of the amending Act can be looked into as "contemporanea exposited" as held by the Supreme Court in K.P. Verghese (131 ITR 597).

As further held in this judgment, the new provisions should be so interpreted as to suppress the mischief and advance the remedy. With regard to the sue of the conjunction and between sub-clause (i) and (ii) of clause (c) of the sub-section Mr. Mitra submitted that it is permissible, in certain, circumstances, to read the provisions disjunctively despite the use of the conjunction and invited our attention in this regard to the judgment of the Supreme Court in Municipal Corporation of Delhi Vs. Tek Chand Bhatia (AIR 1980 SC 360).

These contentions were controverted on behalf of the department, especially the applicability of the Heydon's rule, and it was contended, relying on the observations at page 348 of Vol. 1 of Chaturvedi and Pithisaria's Income tax law that the rule is not applicable where the statute is unambiguous,which is the case with clause (c) of the sub-section.

14. Despite the forceful point made by Mr. Mitra we are unable to hold that sub-clauses (i) and (ii) of clause (c) of sub-section (3) should be read disjunctively. This point has been specifically decided by the Bombay High Court in IPCA

laboratories (supra) and it has been held that the word "and" should be read a s conjunction. As regard the mischief rule (Hyedon's rule), since the issue has been decided in the above judgment, it is not proper for us, as lower tribunal, to tray to overcome the same merely on the ground that this rule of interpretation was not considered therein. The point in issue has been directly decided in the judgment, and earlier in this order we have given our reasons as to why we have preferred to adopt the reasoning of the judgment. The general argument (raised by all the learned counsel and learned representatives for the assessees and interveners) that these is no direct judgment of the Delhi High Court on the issue (in fact, on all the three issued before us) which is binding on the Special Bench sitting at Delhi and hence we are free to take a view different from the view taken by other High Courts puts us in considerable predicament as it cannot be postulated a all that a lower court or tribunal can take a view inconsistent with or unguided by a judgment of a superior court or tribunal, albeit of different state, in the absence of any judgment of the jurisdiction High Court in the point. The golden rule of interpretation of taxing statutes that where two reasonable views are possible the view in favour of the tax-payer must be adopted is a simple rule which could be followed by Division Bench of the Tribunal when confronted with judgment of High Courts other than those of the jurisdictional High Court but hat rule may not always, work effectively when a Special Bench is constituted to decide the issue, for, if the Special Bench is merely to adopt the rule the same can be done with equal ease by a division Bench also and a reference to a Special Bench can turn into an academic exercise. Therefore there is a duty cast on the Special Bench to examine the issue in the light of the various views expressed by the High Court of other States and take guidance from them with utmost respect and humility. But even so, such as examination can cover only a limited sphere, for, as already pointed out, no lower tribunal can afford to take the weight to the judgment of High Courts, through of different States, lightly and proceed to consider the entire issue afresh, as if for the first line in a spirit of judicial adventurism. Perforce, the enquiry into the problem will have to be circumstances by the parameters of judicial decorum, discipline and propriety. But the problem gets compounded because any attempt at a solution to the questions posed before the Special Bench, which are concluded one way or the other by judgment of High Courts of other States (States

other than the State where the Special Bench is sitting), would necessarily involve the making o a conscious choice to follow one view or the there which in turn involves the giving of reasons for the choice. The Special Bench is thus placed in a somewhat tricky position where it must act with great circumspection and responsibility. The reasons given for taking the choice and the language used should not be adventuristic or attempt to cross the frontiers that are never to be crossed. The Special bench has to guard against any such tendency. However, having been constituted it has to decide the issue. Taking guidance from the judgments and giving cogent and acceptable reasons tempered with judicial dignity, discipline and decorum and without crossing the we I demarcated frontiers. If it feels judicially inclined to prefer one decision over the one. for instance, if the provisions of law considered in those judgments were different, of it there has been an amendment of the law thereafter, of if the judgment was rendered per incurium without reference to earlier judgment of the Supreme Court or binding judgment of the same High Court, of if the facts of the case of the context or the controversy were different, of if the correct legal position does not appear to have been brought of the notice of the court - in such cases (which are only illustrative) if is only by explaining the judgments properly and by giving reasons as to why it prefers on judgment over the other that the Special Bench has to come to one on the other conclusion. We felt the need to make these observations because in it is case were have preferred the view taken by the Bombay High Court in deciding the first question, though a contrary view was been expressed by the Kerala High court which is in favour of the assessee, and in doing so have departed from the use that if there are two views possible the view in favour of the taxpayer must be adopted.

15. We not turn to the second question referred to us. The controversy in brief is this. The proviso says that the profits computed under the three clauses of sub-section (3) "shall be further increased" in the proportion which ninety percent of the export incentives mentioned in sections 28 (iiia), (iiib) and (iiic) bears to the proportion which the export turnover bears to the total turnover of businesses carried on by the assessee. Now what happens if the assessee suffers a loss under any of the three sub-clause and is in receipt of the export incentives? The assessee say that the loss will have to be ignored and cannot be adjusted or set

off against the proportion of the export incentives computed under the proviso. The income-tax authorities, on the contrary, say that the loss will be adjusted and the export incentives will be reduced by the loss.

16. Mr. Sapra, the leaned counsel for M/s. Essel International in ITA No. 3395/Del/1997, contended as follows, (a) the proviso appeals only to export incentives referred to in sec. 28(iiia), (iiio) and (iiic).

Whereas the Explanation (baa) defines "profits of the business' as a while; (b) if the loss arising under any of the clauses of sub-section (3) is adjusted against the incentive, the whole object of the section, which is to encourage exporters, will be defeated ; (c) sec 80-HHC is a beneficial provision and should be liberally interpreted ; (d) at any rate, if two interpretations are reasonably possible, the once in favour of the assessee should be adopted, and (e) the assessee's own case for the assessment year 92-93 having been decided by the Tribunal in its favour, the rule of consistency demands that if should not be departed from.

17. In support of the above contention, Mr. Sapra invited our attention to the following judgments/order : iv) Indian Sugar and General Industries Vs. DCIT (121 Taxman 305) (Delhi) v) Vishal Exports Overseas Ltd. Vs. ITO (Mumbai Bench) (ITA No. 1248/MUM/2002 dated 20th Jan 2003) 18. Mr. Ajay Vohra the learned for M/s. Eicher International (Intervener), put forth the following contentions : (a) Though a negative profits (loss) can be arrived at under the three clauses of sub-section (3), considering the language of the proviso thereto, which uses the expression "further increased", it implies that if here are profits under the three clauses they shall be "further increased" and the context of losses the expression will have no meaning and has to be ignored. In this regard, he invited out attention to the judgments of the Delhi High court in Modi Cements Ltd. (193 ITR 91) and Allahabad High Court in Indo Gulf Fertilisers & Chemicals Corporation (195 ITR 485), in which the provisions of sec 143(1A), where the words "further increased" appear, were considered.

(b) Sec. 271(1)(c) uses the expression "in addition to any tax payable" which has been held to mean that if only there is some tax payable consequent to the assessment, can penalty be levied and if the assessment is upon a loss and no

tax is therefore payable, there is no question of paying any penalty. Just as the existence of some tax payable is a condition for levying penalty, the existence of profits under the three clauses of sub-section (3) is a condition for applying the expression "further increased" and where the assessee suffers losses under those clauses there is no case for applying the said expression.

(c) The proviso should be construed as an independent provision because the export incentives referred to in sec. 28(iiia), (iiib) and (iiic) have been excluded from the definition of "profits of the business" in Explanation (baa) and thereafter brought back under the purview of the deduction by means of the proviso, which shows a conscious step taken by the legislature to allow deduction for the export incentives even it case of a loss under any of the three clauses of the sub-section. Reliance is placed on the judgment of the Supreme Court CIT, Kerala & Coimbatore V. P. Krishna Warrier (53 ITR 176) and on the commentary of G.P. Singh on "Principles of statutory interpretation" (8th ed. 2001, @ pages 179 181) in support of the contention that sometimes it may become necessary to construe a proviso as an independent provision or a fresh enactment.

(d) The circular issued by the Board (195 ITR St. 154 @ 177) shows that even if there is a loss in the export business under the three clauses of the sub-section, the assessee would be entitled to get deduction in respect of the export incentives.

(e) The judgment of the Bombay High Court in IPCA laboratories (supra) which is sought to be relied upon by the income-tax authorities as authorizing the adjustment of the losses against the export incentives, does not deal with the precise controversy in the case, the proviso was not considered. The aggregation was permitted because of the conjunction "and" occurring between sub-clause (i) and (ii) of clause (3). The question whether the losses can be adjusted against the export incentives under the proviso was not before the High Court. The point of distinction has been noticed by the Mumbai Bench of the Tribunal in Vishal Overseas Exports (supra) Chandigarh Bench in Avon Cycles (supra) and by the Ahmedabad Bench in ACIT Vs. Sumedh Synthetics (81 TTJ 84). At any rate, the judgment of the Bombay High Court in IPCA (supra) cannot be considered to be binding on Special Bench sitting in Delhi, as held in the following judgments. :All

India Lakshmi Commercial Bank Officers Union & Anr. v. Union of India & Ors.

f) The judgment of the Kerala High Court in Smt. T.C. Usha (Supra) should be preferred to the judgment of the Bombay High Court in IPCA (supra) as the former is in favour of the assessee, on the basis of the rule laid down by the Supreme Court in Vegetable Products (supra).

g) In the following cases, it has been held that the loss cannot be adjusted against the export incentives under the proviso, and the reasoning therein should be preferred : i) Alpine Solvex Ltd. V. DCIT (Indore Bench) - against which the appeal to the High Court has not been admitted (copy of order & judgment filed in the paper book) 19. The learned counsel for the assessee in ITA No. 1805/Del/99 (M/s.

Tee Ess Exports (P) ltd. adopted the argument of Mr. Ajay Vohra.

20. Mr. Prahlad Singh, the learned CIT(DR) put forth the following contentions on behalf of the Department : a) The interpretation placed by the Department upon the proviso does not as claimed on behalf of the assessee make it unworkable. The very object of the proviso is to allow the deduction for export incentives only if the export business shows a profit. In case it shows a loss, the object is not allow any deduction in respect of the export incentives. This is the basis premise of the proviso.

Reliance is placed on the order of the Calcutta Bench of the Tribunal in the case of Yarn Syndicate (79 ITD 189).

b) The proviso shall not be read as an independent provision as claimed on behalf of the assessee. It must be read as subordinate to the main provision, in the traditional manner of interpreting a proviso proper.

c) The effect of the contentions on behalf of the assessees is that the loss has to be taken as "nil". There is no such express or implied mandate in the proviso. It is implicit in the proviso that just as profits have to be "further increased", losses have to be reduced from the export incentives.

d) The proviso says that the profits computed under the various clauses of the sub-section "shall be further increased". The use of the word "shall" shows that the proviso can operate only if there is a profit-base and it cannot act independently of the existence of the profit-base.

e) If the contention of the assessee is accepted, then even if the loss in the export activity is larger than the export incentives, they will be entitled to the deduction, a consequence which cannot be countenanced.

f) The question of applying the rule of liberal construction does not arise when the language of the provision is clear, and if the language is clear the rule of literal construction shall apply.

Thus, the proviso will apply only where there is a profit under any of the clauses of the sub-section. The proviso does not refer to a situation where there is a loss. Literally construed, in such a case, the proviso simply does not apply. The ratio of the judgment of the Supreme Court in CIT Vs. B.C. Srinivasa Setty (128 ITR 294) is attracted.

21. Mr. Jain the learned Senior Dr, supporting the case of the department, submitted that there is no logic in allowing deduction even if these is a loss in the export activity. Accordingly to him, in case of a loss, the grant of export incentives itself is sufficient, and no further relief of the assessee is due. He relied on the judgment of the Supreme Court in H.H. Ravi Varma Raja (205 ITR 433) in support of the submission.

22. In their reply, the learned counsel for the assessee, Mr. Sapra and Mr. Ajay Vohra, submitted as follows.

a) According to the circular of the Board reported in 190 ITR St.

299, the tax concession is given to compensate the exporters for the loss they incur in the competitive export market and the interpretation placed by the income-tax authorities upon the proviso goes contrary to such an intention.

b) The proviso cannot be interpreted in such a manner as to defeat the intention of the law. The language should not be stretched and strained to deny relief. The proviso should be interpreted reasonably, giving each word its meaning.

c) The judgment of the Supreme Court in Srinivasa Setty (supra), relied on by the department, was rendered in the context of the charging provisions of sec. 45 of the IT act and therefore the ratio cannot be blindly applied to a beneficial provision.

d) The purpose of defining "profits of the business" in Explanation (baa) introduced with effect from 1-4-1992,by excluding the export incentives from its preview but a the same time bringing it back under the proviso to sub-section (3), is only to allow deduction at least in respect of them, even if the assessee suffers a loss in the actual export business.

e) The Gujarat High Court held in CIT vs. Arvind Mills Ltd. (254 ITR 529) that section 80-HHC is subject to sec. 80-B(5) with the result that in the ultimate computation of the total income an assessee may get relief in respect of export even from capital gains.

23. We have carefully considered the matter. There is no direct authority of the Hugh court on the interpretation of the proviso. The proviso deals with export incentives. It envisages an additional deduction for export incentives. They are first excluded from the "profits of the business" by Explanation (baa). This only shows that export incentives cannot be treated as part of the profits of the business. But, as rightly pointed out on behalf of the assessee, they are brought back within the purview of the deduction by the proviso. In the main provisions of sub-section (3), what is dealt with is only the result of the export business or businesses. The proviso goes on the enlarge the scope of the deduction by including the export incentives.

It seems to us therefore that the proviso stands on its own and has to be interpreted as if it is an independent provision. It cannot be understood in the same manner of understanding a proviso proper, in the conventional hence. The function of a proviso normally is to carve out an exception which, but for the proviso, would have fallen within the main provision. But "the insertion of a proviso

by the draftsman is not always strictly adhered to its legitimate use and at times a section worded as a proviso may wholly or partly be in substance a fresh enactment adding to an not merely excepting something out of or qualifying what goes before" (pl. see pages 179-180 of "Principles of statutory interpretation" by G.P. Singh 8th ed. 2001). If this principle is applied, it will be seen the proviso is not one in the real and conventional sense.

24. Before 1-4-1992, the date on which the provision of sub-section (3) were amended, the sub-section provided for a simpler form of deduction in the sense that the exporter was entitled to a deduction of the profits computed under the head "profits and gains of business" in the proportion which the export turnover bears to the total turnover.

implicit in this was the principle that if there is a loss computed in the export business, no deduction was allowable. The amendment brought about a different scheme of deduction devised more elaborately, distinguishing between export of trading goods and export of manufactured goods. The proviso was also brought by the amendment. In circular No. 521 dated 19-12-1991 (195 ITR St. 154 @ (177) explaining the amendment, it was recognized in para. 32.7 that "the tax concession under section is intended to compensate an exporter for the comparative disadvantage faced by him in the international market. With a view to ensuring that the tax concession is not misused, sub-section (3) of section 80-HHC of the Income Tax Act has been amended". Sub-para. (d) of para.32.8 says "the profits shall be increased by the amount which bears to ninety percent of the export incentives (profits on sale of exim scrips, receipts by way of duty drawback or payments under the International Price Reimbursement Scheme (IPRS) the same ratio as the export turnover bears to the total turnover". If the intention is to compensate the exporter for the disadvantage he suffers on account of international competition, it appears to us that there is no logic in saying that if he incurs a loss in the export business on account of such competition, he would either be denied the deduction with reference to the export incentives or it would be reduced by the amount of the loss. A loss-making exporter obviously needs more encouragement.

It would be inconsistent, in our humble opinion, to say in one breath that an exporter making profits would further enjoy a deduction with reference to the export incentives and to say in the same breath that an exporter suffering losses would either lose, or would get only a reduced deduction for the export incentives. Whether the exporter makes profit or suffers loss in the export business because of the method of computation prescribed in sub-section (3), it cannot be overlooked that he does bring in precious foreign exchange. The proviso therefore cannot be interpreted in a manner that would result in such injustice.

25. But then it was contended by the Revenue that the existence of the profits in the export business is some sort of a condition for the application of the proviso and only if profits are derived can they be "further increased". and if there is only a loss, there is no question of anything being "further increased". The contention on behalf of the assessees is that in the case of a loss, it has to be ignored since there can be no question of a loss being "further increased". It is common ground that the proviso does not expressly provide for the contingency of a loss arising in the exports. At best (or worst), it can only be said that it is silent on this aspect. The judgments of the Delhi High Court in Modi Cement Ltd. (supra) and the Allahabad High Court in Indo Gulf Fertilisers & Chemicals Corporation (supra) cited on behalf of the assessees were rendered in the contex of the levy of additional tax under sec. 143(1A) and the question arose whether in a case where the loss returned by the assessee is increased as a result of the assessment, the AO can treat it as a case of a "further increase" of the tax payable. It was held that where no tax is payable as a result of the assessment there is no question of it being "further increased" by an additional levy. It seems to us that it would not be apposite to draw support from these judgments for the purpose of the interpreting the proviso which is before us. They were rendered in the context of a levy of tax. If there is no initial levy of tax, there is no question of an additional levy. This is what was held. In doing so, the words "further increase" in sec. 143(1A)(a)(i) were relied upon to hold that there is nothing to be "further increased" if first of all there is no tax payable because of the assessment having been made on a loss. The analogy of sec.271(1)(c)(ii) and (iii) where the penalty is payable "in addition to any tax payable" is also not appropriate to the problem before us. The proviso with which we are concerned is more complex. Even the Revenue does not contend

that in case of a loss in the export business under any of the three clauses of the sub-section the proviso is not attracted at all and that the assessee would not be eligible for any deduction in respect of the export incentives. If that was their stand then they would not have adjusted the loss against the appropriate proportion of the export incentives; they would have simply held that the assessee is not entitled to any deduction under the proviso. What they contend is that the loss would be adjusted against the export incentives to reduce the deduction. If it is conceded that even in the case of a loss the proviso is attracted, then there is, in our humble view and with due respect to every one concerned, no logic in saying that it would be set off against the export incentives. The loss in the export business and the grant of export incentives referred to sec 23(iiia), (iiib) and (iiic) of the Act represent different species of income. That the export incentives are not to be considered as "profits of the business" for the purpose of sec.80-HHC is made clear by Explanation (baa). When it is brought back within the perview of deduction by the proviso to sub-section (3), it is not brought back as "profits of the business" but as a separate category of income.

Therefore, though the proviso permits the adding up of the prescribed proportion of 90% of the export incentives to the profits of the export business by saying that the latter "shall be further increased" by the former, an intention to reduce the latter by the loss suffered in the export business under any of the clauses of the sub-section cannot be read into or inferred from the proviso. If you earn profits from the export business, your entitlement to the deduction will be in respect of such profits plus the deduction in respect of the prescribed proportion of 90% of the export incentives; on the other hand, if you suffer losses in the export business, your entitlement to the deduction will be restricted to the prescribed proportion of 90% of the export incentives. It seems to us that the intention behind enacting the proviso is to reward profit-making exporters by a further deduction, but at the same time not to punish or discourage loss-making exporters by reducing the deduction in respect of the export incentives. This is so because the object behind enacting sec. 80-HHC is "to compensate an exporter for the comparative disadvantage faced by him in the international market" and the reduction of the deduction given in respect of the export incentives (by the proviso) by the amount of loss suffered in the export business would, in our humble view,

run counter to the object.

26. In IPCA Laboratories (supra) the Bombay High Court was not concerned with the proviso to sub-section (3) of sec.80-HHC. The question before the High Court was limited to the interpretation of clause (3) of the sub-section. It was held that the word "profits" in sub-section (1) means positive income and does not include loss (negative income), that however the word "profits in sub-section (3) would include losses, that on this basis the loss suffered by an exporter, who carries on both export of trading goods and manufactured goods and thus falls under clause (c), on export of trading goods shall be set off against the profits earned in the export of manufactured goods and that the idea of such adjustment or set off is conveyed by the conjunction "and" employed between sub-clauses (i) and (ii) of the clause. This judgment did not decide the question as to what would happen if the proviso to the sub-section is applied to a case of a loss under any of the three clauses of the sub-section. The question was not before the High Court. The question posed was.

"Whether the loss in respect of export of trading goods was to be ignored while determining the appellant's entitlement to deduction under section 80-HHC(c) of the Act?" 27. It would appear to us that the Revenue has taken inspiration from this judgment, albeit to a limited extent, to contend that the idea of set-off or adjustment or aggregation runs right through sec.80-HHC, including The proviso. The difficulty in accepting this contention is that, as we have already seen, the proviso has been enacted not as a "real proviso" in the conventional or raditional sense but as an independent or substantive provision. It would therefore be inappropriate to extend the idea of an adjustment of a positive figure and a negative figure, inter se, beyond clause (c) of the sub-section.

We are therefore of the view that the judgment of the Bombay High Court in IPCA Laboratories (supra) cannot be brought in aid of the Department's stand vis-a-vis the proviso.

28. We now move on the deal with the third question, which, briefly put, is whether Explanation (baa) permits the principle of "nothing" when it speaks of excluding certain types of receipts. Though the clause refers to many types of receipts such

as interest. rent, commission, brokerage etc. the question referred to us specifically refers only to interest. The importance of the question is this. If the gross receipts are removed from the profits of the business. as the Department wants to, the profits eligible for deduction u/s.80HHC would be substantially reduced and may even become a negative figure whereas if only the net receipts (gross receipts minus expenses incurred to earn them) are excluded from the profits of the business, as the assessees claim, then there would be substantially more profits of the export business left to enjoy the deduction. The following example may roughly explain the controversy: Applying Explanation (baa) to the above computation, or purposes of computing the deduction u/s.80HHC, the following position emerges: 29. The issue arises in the case of Lalsons Enterprises, the appellant in ITA No.3990/Del/99. The arguments of Mr. Ajay Vohra, the learned counsel for the assessee, were heard along with the arguments of Mr.

Rajan Vora, the learned chartered accountant from Bombay appearing for the intervener M/s. Price Waterhouse, Calcutta for the intervener M/s.

Exide Industries. On behalf of the Department, we heard the arguments of Mr. Salil Gupta and Mr. Prahlad Singh, the learned CIT(DRs) and the learned Senior Departmental Representative.

30. The issue is whether the assessees' claim that the interest receipt is to be "netted" by setting off the interest expenditure. It will be seen from the above rough example that if the claim is accepted the assessee will be eligible to a higher deduction. Mr. Ajay Vohra, the learned counsel for Lalsons Enterprises contended as follows: a) Any suggestion that the word "receipts" appearing in the Explanation refers to gross receipts is negated by the last three words of clause (1) "included in such receipts". What is included in "such receipts" is only the net income by way of interest (i.e., interest receipt minus interest expenditure). This idea has been explained by the Supreme Court in CIT v Distributors (Baroda) P. Ltd. (155 ITR 120).

b) Wherever the legislature wanted to refer to the gross amount of receipt credited to the profit & loss account and not of the gross receipt reduced by the expenditure

debited to the profit & loss account (i.e., the net income), it has clearly said so. Sec.44AA and Sec.44AB may be seen, where the expression used is "gross receipts" c) The word "receipts" occurring in clause (1) of the Explanation is used only to denote or describe the type or kind of income which follows immediately - "receipts by way of brokerage, commission, interest, rent, charges or any other receipt of a similar nature." Therefore, the nonuser of the word" income" does not mean that the receipts of the type referred to are gross receipts. Wherever the legislature wanted to use the word "receipt" and "income" interchangeably it has done so clearly, for eg., in Explanation (f) and (ii) of Sec. 115JB. d) The principle of netting has been recognized in the Act.

Sec.40A(8) and the Explanation I below Sec.40(b) (as it stood before being substituted w.e.f. 1-4-1993) are examples. In fact, Explanation I below sec.40(b) is a statutory recognition of the judgment of the Supreme Court in Keshavji Raiji (183 ITR 1) where it was held that while disallowing interest paid to partner, in the computation of the firm's income the interest received from him shall be adjusted and only the net interest paid, if any, shall be disallowed.

e) The purposive rule of interpretation should be adopted in understanding Explanation (baa). (Pl. see Calcutta Bench order in the case of Chloride India Ltd. (53 ITD 180) affirmed by the Calcutta High Court in 256 ITR 625).

f) The circular No.621 explaining the provisions of Explanation (baa) (195 ITR ST. 154) recognizes that there may be some common expenses and estimates an ad hoc 10% of such common expenses to be allowed as deduction against the receipts such as interest, brokerage, commission etc. But this deduction is only for common expenses. Deduction in respect of expenditure which has a nexus with the receipts of the nature referred to in the Explanation has to be allowed further, which is not prohibited.

31. Mr. Rajan vora, the learned representative for M/s. Swani Corporation, intervener, submitted as follows: a) Under Explanation (baa) the computation of business income is to be made as per the computation provisions of secs.28 to 44D and not as per the Profit & Loss account. This means that the expenditure to earn the receipts has to be allowed as deduction. Automatically therefore, the

exclusion can be only of the net income.

b) The orders of the Mumbai Benches of the Tribunal in Pink Star v DCIT (72 ITD 137) and DCIT v Diamond Creek (82 ITD 291 illustrate the illogic in the interpretation sought to be placed by the Department.

c) In CIT v Karnal Co-operative Sugar Mills (243 ITR 3) the Supreme Court has distinguished its judgment in Tuticorin Alkali's case (227 ITR 172) and has held that in the case of a running business interest paid shall be adjusted against the interest received.

d) There are observations in the order of the Special Bench of the Tribunal in Surendra Engineering Corporation v ACIT 86 ITD 121) supporting the interpretation placed by the assessees on the Explanation.

32. Mr. Rahul Mitra, the learned representative for M/s. Exide Industries (intervener), put forth the submission that while applying the rule of exclusion under the Explanation, though the language suggests that or by 10% of the receipts shall be allowed as a deduction, the assessee should be given the option of showing that the actual expenditure is more and in support of the submission relied on the judgment of the Supreme Court in Union of India v A. Sanyasi Pao and others (219 ITR 330) and the judgment of the West Bengal Taxation Tribunal in Sankar Lal Das v State of West Bengal (226 ITR (A.T) 35.

33. On behalf of the Department, the following submissions were put forth by Mr. Prahlad Singh, CIT (DR): a) The assessees' contention has the effect of introducing the word "net" before the word "receipts" in the Explanation which is not permissible. It is not permissible to introduce words into the provision. See the judgment of the Gujarat High Court in Parashottam Nagindas B.R. Adwalpalkar (218 ITR 402).

b) Accounting principles, such as "netting", cannot over-ride the provisions of law as held by the Supreme Court in Tuticorin Alkali's case (supra).

c) The word "receipt" connotes what comes in and the idea of what goes out (expenditure) is alien to it.

d) The judgment of the Supreme Court in V.P. Gopinathan (248 ITR 449) reiterates that the interest paid cannot be adjusted against the interest received.

e) When the Explanation allows only 10% deduction it is not permissible to hold that the assessee is entitled to deduct further expenditure though actually incurred.

f) The interpretation suggested by the assessees will result in the Explanation becoming unworkable in case the expenditure is equal to or more than the receipt.

a) In the case of interest, there can be three possible situations.

First, the interest is not related to the business at all, in which case sec.80HHC is not applicable. The second is that where interest is credited to the profit and loss account, the interest expenditure is connected surely with the exports, in which case it cannot be adjusted against the receipt. The third is that where the interest expenditure is directly connected to the earning of the interest income, it may be adjusted against the receipt.

b) If netting principle is accepted, it would mean that the Department would also be entitled to deduct the expenditure incurred to earn the export incentives referred to in sec.28(iiia), (iiib) and (iiic).

c) Sec.80-M and sec.80-L refer to deduction from "income", in contrast to the word "receipt" used in Explanation (baa) which shows that where the legislature wanted to allow deduction for net income, they have expressly said so.

d) The provisions of Secs. 44AA and 44AB have been enacted to provide for a different situation in a different context. They are not provisions relating to computation of income and are not for determination of eligibility to any deduction. Reliance on them by the assessees is misplaced.

e) The correct conclusion has been reached in the orders of the Delhi Bench of the Tribunal in the case of Sutlej Industries and DCIT v J.R. Sharma Overseas Pvt Ltd which contain the reasoning (orders compiled in the paper book).

f) Sec.28(iiia), (iiib) and (iiic) refer to gross amounts of the receipts by way of cash assistance, duty drawback etc. Therefore, the Explanation, when it refers to these

sections, refer only to gross amounts. If that is so, the other receipts mentioned in the Explanation (interest, brokerage, rent etc.) have also to be taken as gross receipts, for the sake of uniform construction.

g) Clause (2) of the Explanation refers to "profits of any branch etc." , in contrast to "receipts by way of brokerage etc." in clause (1). This itself shows a conscious taken by the legislature to exclude any idea of "netting" in clause (1).

h) Explanation (aa), (b) and (ba) - all contain specific exclusionary words, whereas no such words are used in Explanation baa).

35. Mr. Jain, the learned Senior DR submitted that the word "receipt" should be understood in its ordinary and popular sense of meaning whatever actually comes in without introducing nuances or subtleties.

The object of section 80HHC being to allow deduction in respect of profits "derived from exports, the Explanation has ensured that only 10% ad hoc deduction would be allowed against receipts unconnected with the exports and this cannot be changed by purporting to apply the purposive approach or any other rule of interpretation.

36. In reply, Mr. Ajay Vohra, the learned counsel for Lalsons Enterprises submitted as follows: a) The Department's contention that since the word "income" (receipt minus expenditure)has not been used in the Explanation, the gross receipt can be excluded overlooks that the concept of "income" is wider than the concept of "profits and gains", and since the Explanation was inserted to define "profits" and gains of the business", which is only a species of "income", the concept of "income" cannot be substituted in the place of "receipt".

b) Since the concept of "income" is narrower than the concept of "gross total income" embedded in secs.80-L and 80-M and therefore the reference to those sections is inapposite. Refer to the judgment of the Privy Council in Maharajkumar Gopal Saran Narayan Singh v CIT (3 ITR 327) and the judgment of the Full Bench of the Allahabad High Court in Rani Amrit Kuer v CIT (14 ITR 561 @ 570).

c) The principle of "netting" is implicit in the words "receipts ....included in such profits" occurring in the Explanation. There is no attempt to introduce words into the Explanation, as alleged by the Department.

d) The Explanation is workable in all cases, even where the expenditure is equal to or more than the receipt.

e) The assessees are not relying on any principle of accounting in support of their contention. The principle of "netting" is implicition the language employed in the Explanation itself.

f) There is no difference in the ideas expressed by clauses (1) and (2) of the Explanation. Whereas the idea of netting is implicition both, only the language employed is different. The words "receipts .....included in such profits" appearing in clause (1) and the word "profits of any branch.." appearing in clause (2) convey the same idea.

g) The judgment of the Supreme Court in V.P. Gopinathan's case (supra) has no application to the facts of the present case.

37. We also sought clarifications from both sides on the applicability of the judgment of the Supreme Court in the case of Karnal Co-operative Sugar Mills (233 ITR 2) which we came across in the course of the hearing and during discussions held amongst us, as also with regard to the facts of M/s Lalsons enterprises, the appellant, in connection with this issue. Accordingly we have heard Mr. Ajay Vohra, the learned counsel for the appellant as well as Mr. Salil Gupta, the Learned CIT(DR). Mr. Rahul Mitra, the learned representative for the intervener, M/s Exide Industries. Mr. Vohra drew our attention to page 46 of the pager book to explain the nature of the interest receipt in the case of Lalsons Enterprises. He submitted that the interest was earned on margin monies placed for obtaining various kinds of facilities from the bank. Out of these facilities, a sum of Rs. 69 lakhs was for purchase of machinery and the balance was for working capital requirements of the business. He contended that the judgment of the Supreme Court in Karnal Co-operative Sugar Mills (supra) is not applicable to the facts of the present case, because in the case before the Supreme Court the

business had not commenced and hence the interest receipt was held liable to be deducted from the cost of the asset, whereas in the present case the business had commenced and is continuing, in which case the judgment is not applicable. He revered to the judgment of the Punjab & Haryana High Court reported in 233 ITR 531, which was affirmed by the Supreme Court, to point out the facts on the basis of which the judgment was rendered. He also relied on the judgment of the Kerala High Court in CIT v. Parry Agro Industries Ltd. (257 ITR 41).

38. Mr. Mitra (for Exide Industries) relied on an unreported order of the Mumbai Bench of the Tribunal in the case of Waterman Steamship, copy of which was filed.

39. Mr. Salil Gupta, the learned CIT DR), drew our attention to the judgment of the Supreme Court in the case of Pandian Chemicals (262 ITR 278) and the judgment of the Kerala High Court in the case of K.Ravindranathan Nair v. CIT (129 Taxman 811).

40. We have considered the issue carefully. According to circular No.621 cited supra, explaining the introduction of Explanation (baa) w.e.f. 1.4.1992, the formula that existed before that date for computing the export profits on which deduction was to be allowed gave a distorted figure "when receipts like interest, commission, etc. which do not have element of turnover are included in the profit and loss account" and it was with a view to removing the distortion that it was clarified through the Explanation "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 income, which in the generality of cases is part of common expenses, ad hoc 10 per cent. Deduction from such incomes is provided to account for these expenses". Now when the legislature has fixed an ad hoc percentage as expenditure incurred to earn the receipts, can it be further argued that only the net income, which means gross receipt by way of commission, interest, rent etc. minus all the expenditure which has a nexus with the receipt, can be excluded from the "profits of the business" as computed under she head "business"? is there any warrant for such an argument? On the language of

Explanation (baa) there is reason to think there is. The ad hoc 10% deduction, given indirectly by saying that only 90% of the receipts will be excluded from the profits of the business as computed, instead of the entire receipts, has been given for common expenses, according to the circular, Such common expenses are generally the indirect o fixed expenses which every businessman has to incur to continue in business, such as salaries and wages, other administrative expenses and so on. In addition to such common expenses, there may be expenses which have a direct bearing or nexus with the receipts by way of interest, commission, brokerage, rent etc. If such receipts are to be taken out of profits of the business on the footing that they have no connection with the business profits or the turnover, it seems only fair and reasonable to hold that the expenditure having a nexus with such receipts should also be taken out of the business profits on the same footing. This conclusion is warranted, in our humble opinion, even on the language of clause (1) of the Explanation. The receipts that are to be excluded from the business profits are those which are "included in such profits". The word "receipts" used in the clause does not, in our view refer to gross receipts merely because the word "net" is not used before i ; nor does it mean, as was suggested on behalf of the Department, to denote what "actually comes in" or what is "actually received by the assessee". This is because of the controlling words, imposing a qualification or condition, which follow, to the effect that the receipts should be those that have been included in the business profits. In the computation of the business profits, only the net income arising out of the receipts are included. In the example given by us earlier in our order, it may be seen that what is included by way of interest in the profits of the business of Rs. 10,700 as computed under the head "business" is only Rs. 3000 (receipt of Rs. 4000 minus interest paid of Rs. 1000) and not the "receipt" of Rs. 4000. The analogy of CIT v Distributors (Baroda) P. Ltd. (supra) was rightly relied on in this connection. In that judgment, in the context of allowing deductions for certain incomes from the gross total income, it was held that what was included as income in the gross total income is the net income, i.e., receipt minus the expenditure which has a nexus with such receipt. The assessee in that case contended what is now being contended before us by the Department, that is to say, that the deduction with reference to sec.80-M must be allowed with reference to the dividend "received",

on the ground that what was received was the gross amount of dividend without being reduced by any expenditure incurred in relation thereto. The Department's stand (similar to the one which is being contended before us by the assessees) was that the deduction could be allowed only with reference to the net income by way of dividend, i.e., gross amount or dividend reduced by the expenditure incurred in relation to it. The stand taken by the Department in that case was upheld by the Supreme Court. In doing so, it was held that what was included in the gross total income as income by was of dividend, on which deduction u/s.80-M was allowable, was only the net income after adjusting he expenditure against the gross amount of dividend, and therefore the deduction was allowable only on the net income. On parity of reasoning, the amount of "receipts" included in the profits of the business as computed under the Act is the gross receipts as reduced by the expenditure incurred in relation thereto. It is this concept that is conveyed by the words "receipts by way of .....included in such profits. The word "receipts" cannot be read in isolation and divorced from the words following viz., "included in such profits", which actually control and qualify the former. In other words, in addition to the ad hoc 10% deduction given for common expenses, the assessee would be entitled to claim expenditure which has a nexus with the receipt by way of interest, commission, brokerage etc.

on the principle of "netting" in view of the language employed in the Explanation.

41. Clause (2) of the Explanation also conveys the same idea by the use of the words "profits of any branch ....." which have to be reduced from the profits of the business as computed. The words "profits" convey the same meaning as "net income", i.e., "gross receipts minus expenses having a nexus" In fact, it would be incongruous to hold that while the legislature recognised the principle of netting in clause (2), it did not do so in clause (1) of the same Explanation, though both the clauses deal with the same subject-matter, viz., exclus on from business profits of something which cannot strictly be called business it come. In clause (2), it is significant to note, no ad hoc deduction is allowed for common expenses, obviously because it speaks of profits of any branch, office, warehouse or any other establishment of the assessee situate outside India, it which case it would not be difficult to ascertain the expenses incurred in maintaining such branch etc.

42. The argument of the Department that since the word "income" has not been used in the place of "receipts", the concept of "netting" cannot be read into the Explanation cannot be accepted because, as rightly pointed out by Mr. Ajay Vohra, the learned counsel for Lalsons Enterprises, the word "income" is of wider import than the words "profits of the business" and therefore it would have been inappropriate to use it.

43. Even if it is accepted that the word "income could have been employed to convey the concept of netting with the result that the Explanation clause (1) would have read".... Income by way of brokerage, commission, interest ....." that does not mean that the existing language can be overlooked. It would have been perhaps a more clear expression of the concept (if the word "income" had been used) but we have to interpret the provision on the basis of the language employed.

There is nothing, in our humble view, in the language of clause (1) of the Explanation which would militate against the principle of netting.

44. The case of the assessees was not put forward before us on the basis of the accounting principles, which do recognise the principle of netting. The income Tax Act itself is concerned with the principle of netting, in the sense that it does not tax the gross receipts but taxes only the gross receipts minus the expenditure incurred in relation thereto. All the computation provisions of the Act, whatever be the head of income, are aimed at bringing only the net income to assessment. Even under the head "capital gains" it is only the gains that are assessed and not the entire sale proceeds. Therefore there is no violence done to he language employed in the Explanation when we read into it the principle of netting. We do not think that any absurdity ensues by doing so.

45. It was argued on behalf of the Department that if netting is allowed then the income-tax authorities would be entitled to deduct expenditure incurred by the assessee for receiving export incentives mentioned in sec.28(iiia), (iiib) and (iiic). We are not sure if this would be to the advantage of the Department. By deducting expenditure incurred by the assessee to earn the export incentives, while applying Explanation (baa), a lesser amount of export incentives will be excluded from the profits of the business as computed, with the result that a larger amount of profits

of the business will be available for the purpose of the deduction. Be that as it may, clause (1) does not permit it. It is in two parts. The first part reduces "ninety per cent of any sum referred to in clauses (iiia), (iiib) and (iiic) of section 28 from the profits of the business. The second part reduces 90% of the receipts by way of brokerage, commission, interest etc included in such profits. The words "included in such profits" qualify the words "receipts by way of...."and not the words "ninety per cent of any sum referred to in clauses (iiia), (iiib) and (iiic) of section 28.

Further, the sum referred to in sec.28(iiia) is the "profits on sale of applicence granted under...." The word "profits" itself implies the principle of netting (gross receipts minus expenditure) and therefore there is no further need to incorporation the principle in clause (1) of the Explanation. The sum referred to in Sec.28(iiib) is the "cash assistance (by whatever name called) received or receivable..." Since what is referred to is the actual cash assistance received, it may not be possible to contend that the expenditure, if any, incurred in this respect should be deducted. The sum referred to sec.28(iiic) is "any duty of customs or excise repaid or repayable as drawback...." This also refers to the amount to which the assessee is entitled to receive back and hence no deduction for expenditure is contemplated. That is the reason why in clause (1) of Explanation (baa) the export incentives are treated as a separate category and the language employed is also different from the language employed to refer to the exclusion on account of receipts by way of brokerage, interest etc., which are treated as a separate category of exclusion.

46. We are however not inclined to accept the argument of Mr. Ajay Vohra, the learned counsel for Lalsons Enterprises, based on the use of the words "gross receipts" in secs.44AA and 44AB. As rightly pointed out on behalf of the Department by Mr. Salil Gupta, those are provisions designed for a different situation and do not impinge on the determination of the eligibility for of the conditions of or the actual computation of any deduction. In our opinion, the Explanation (baa) has to be construed on its own terms, keeping in mind the general scheme of sec.80HHC, which is perceived to be a self-contained provision.

47. What now remain for consideration are the judgments of the supreme Court in V.P. Gopinathan (supra) and Karnal Co-operative Sugar Mills (supra). In order to appreciate the relevance of these decisions to the issue under consideration, the facts in these cases have to be noted.

In V.P. Gopinathan's case (supra), the facts as we find from the judgment of the Kerala High Court reported in 229 ITR 801, the assessee received certain amount of interest on the fixed deposits placed with banks. He took a loan against the fixed deposits and paid interest thereon. In his income-tax return, he set off the interest paid against the interest received. The Kerala High Court allowed the claim, but on appeal by the Department the Supreme Court reversed the judgment of the High Court. It is seen from the facts of the case that in the assessment the AO brought the interest to tax under the head "income from other sources" and not under the head "business". The assessee did not contest the head of income under which the interest was assessed.

It was on these facts that the Supreme Court held that the interest paid cannot be deducted from the interest received on the basis of the theory of real income, because (a) if the assessee had taken a loan from a different bank and paid interest thereon he would not have been entitled to claim deduction in respect of the interest paid to that bank and if so, the mere fact that he received and paid interest to the same bank should make no difference to the position in the eye of law; (o) the interest received on the fixed deposits constituted income in the assessees hands; (c) such income shall stand diminished only if there is some provision in enabling it and that (d) there was no provision in law. It will be seen that this judgment dealt with the real income principle and it was held that the fact that the interest was received and paid to the same bank did not enable the assessee to adjust them on the basis of the real income principle. It was also observed that there was no provision in law to permit the adjustment.

It must be remembered that in that case the interest received on fixed deposits was assessed under the head "other sources" and before the Tribunal the assessee had given up his claim for deduction of the interest paid u/s.57(iii). This fact has been noted by the Supreme Court. The plea of real income having failed,

and in the absence of any provision permitting the deduction of the interest paid, the adjustment could not be permitted. In the present case, however, the principle of netting is pressed into service not on the basis of the theory of real income (we did not hear any of the learned counsel or learned representatives for the assessees/interveners raise the plea) but on the basis of the computation provisions relating to the business income. If the interest received is found to have a nexus with the business, still it remains to be excluded for the profits of the business by virtue of Explanation (baa)(1), but the claim is that the quantum of such interest income to be excluded must be determined in accordance with the computation provisions relating to business by allowing expenditure by way of interest which bears a nexus with the interest receipt. The computation provisions include sec.37(1) under which any expenditure incurred or laid wholly and exclusively for the purpose of the business is to be allowed as deduction. Therefore any expenditure incurred which has a connection or nexus with the interest receipt has to be allowed as a deduction and only the balance can be excluded from the business profits. There may be other provisions in the computation sections permitting other allowances or deductions, provided a nexus is established between the expenditure and the interest receipt. Thus, there are statutory provisions which authorise the claim of the assessees in the case before us when they contend that the net income by way of interest be computed and excluded from business profits. This takes the case out of the purview of the judgment.

48. In Karnal Co-operative Sugar Mills (supra), the facts as seen from the judgment of the Punjab & Haryana High Court reporter in 233 ITR 531, are that the interest was received by the assessee on fixed deposits placed with the banks in connection with the purchase of machinery. The finding of the income-tax authorities was that the business had not commenced. It was held that the interest received would go to reduce the cost of the machinery and will not be taxable as income from business or under "other sources". This case does not help the case of the Department with regard to the controversy before us.

The controversy before us has arisen only in the background of the fact that the assessee is engaged in the business of exports and such business has been

carried on during the relevant previous year.

Obviously, the question of applying sec.80-HHC and the manner of computing the "profits of the business" of exports in accordance with Explanation (baa) will come in for consideration only if the export business has been carried on during the previous year. The judgment of the Supreme Court in Karnal Co-operative Sugar Mills (supra) relates to a stage where the business was not commenced and no profits were earned, whereas the present controversy arises in circumstances where the assessee carried on export business during the previous year and also earned profits in that business. Where business has already commenced and was carried on during the relevant previous year, the principle of Karnal Co-operative Sugar Mills can have no application, even though the margin monies were placed by the assessee in connection with the purchase of machinery. In CIT v Bokaro Steel Ltd, 2002-TAXINDIAONLINE-161-SC-IT, (236 ITR 315) also, the Supreme Court was concerned with a situation where the business had not commenced and it was held that the interest received on monies placed with the bank in connection with the purchase of plant and machinery is linked with the process of setting up the plant and machinery and would therefore go to reduce the cost of the assets. The interest was held to be a capital receipt not taxable as income. This decision was in fact applied in Karnal Co-operative Sugar Mills Case by the Supreme Court.

Thus both Bokaro Steel and Kanral Co-operative Sugar mills stand on a different footing from the present case and hence not applicable.

(i) For purposes of clause(c) of sub-section (3) of Sec.80HHC, the loss arising in either the export of manufactured goods or trading goods shall be set off or adjusted against the profits arising in the other business. In other words, the results of the business of export of manufactured goods and the business of the export of trading goods shall be adjusted against each other.

(ii) For the purpose of computing the deduction allowable under the proviso to sub-section (3) of sec.80HHC in respect of the export incentives mentioned in sec.28(iiia), (iiib) and (iiic), the loss, if any, suffered by the assessee under any of the clauses (a), (b) or (c) of the sub-section shall be ignored and the deduction

shall be allowed in respect of the amount computed under the said proviso.

(iii) For the purpose of applying Explanation (baa) below sub-section (4B) of section 80HHC and while reducing 90% of the receipt by way of interest from the profits of the business, it is only the 90% of the net interest remaining after allowing a set off of interest paid, which has a nexus with the interest received, that can be reduced and not 90% of the gross interest.

50. The appeals will now be placed before the Division Bench for being disposed of in accordance with our decision. It will be open to the assessees to place all the relevant facts before the Division Bench in connection with the principle of netting raised in question No.(iii) and seek to establish the nexus between the interest paid and the interest received.