

CASE NO.:
Appeal (civil) 4409 of 2005

PETITIONER:
Commissioner of Income Tax, Coimbatore

RESPONDENT:
M/s. Lakshmi Machine Works

DATE OF JUDGMENT: 25/04/2007

BENCH:
S.H. KAPADIA & B. SUDERSHAN REDDY

JUDGMENT:
J U D G M E N T

WITH

Civil Appeal Nos. 4411/2005, 5370/2005, 5372/2005, 5939/2005, 6145/2005, 3037/2006, 2596/2006, 917/2006, 919/2006, 920/2006, 1494/2006, 1495/2006, 3389/2006, 4572/2006, 5157/2006, 3616/2006, 3911/2006, 3913/2006, 3615/2006, 3169/2006, 4738/2006, 5688/2006, 2907/2006, 3496/2006, 5860/2006, 165/2007, 683/2007, 431/2007, 991/2007, 248/2007, 1162/2007, 163/2007, 1636/2007, 1637/2007, 1529/2007, 1530/2007, 1532/2007, 1533/2007, 1266/2007, 1536/2007
Civil Appeal No. 2145 of 2007 arising out of S.L.P. (C)No.16085/2006,
Civil Appeal No. 2146 of 2007 arising out of S.L.P. (C)No.16752/2006,
Civil Appeal No. 2147 of 2007 arising out of S.L.P. (C)No.18239/2006,
Civil Appeal No. 2148 of 2007 arising out of S.L.P. (C)No.6633/2006,
Civil Appeal No. 2149 of 2007 arising out of S.L.P. (C)No.3513/2007,
Civil Appeal No. 2150 of 2007 arising out of S.L.P. (C)No.7911/2007
arising out of CC 10725-10726/2005

Kapadia, J.

Leave granted in special leave petitions.

All the above civil appeals deal with a common question of law and, therefore, they are decided together by this judgment. For the sake of convenience, the facts in C.A. No.4409 of 2005 are mentioned hereinbelow.

For the assessment year 1993-94 M/s. Lakshmi Machine Works (assessee) filed its return of income declaring its taxable income of Rs.50.80 lakhs. On 10.6.94 intimation under Section 143(1)(a) of the Income Tax Act, 1961 (for short, 'the Act') was sent by the Department accepting the returned income. Later on the Department issued notice under Section 143(2) of the Act. One of the items for issuing the said notice was the quantum of deduction under Section 80HHC of the Act. The assessee had computed the allowable deduction under Section 80HHC without taking into account in the total turnover the sales tax and excise duty. The assessee was asked to explain why the total turnover should not be recomputed by including sales tax and excise duty. In this connection, the Department placed reliance on the judgment of this Court in the case of M/s. Chowringhee Sales Bureau (P) Ltd. v. C.I.T. West Bengal [1973] 83 ITR 542(SC). The assessee objected to the above inclusion. However, that objection was dismissed by the A.O. on the ground that under Section 80HHC(ba) deduction from "total turnover" was restricted only to three items, namely, profit on sale of import licence, duty drawback and CCS. The A.O. further held

that from the profits of business, the assessee was entitled to deduct the above three items and also brokerage, commission, interest, rent, charges or any other receipt of similar nature. Before the A.O., the assessee contended that items which cannot be regarded as profits, the question of treating those items as part of "total turnover" did not arise. The A.O. treated certain miscellaneous receipts and interest receipts as part of business profits to which the assessee objected. The assessee pointed out that under Section 80HHC as it stood in the assessment year 1993-94, a deduction of 10% was allowed whereas the balance 90% stood excluded from the business profits. However, the assessee's argument for non-inclusion of sales tax and excise duty was not accepted by the A.O.

Aggrieved by the above decision, the matter was carried in appeal to the C.I.T. (Appeals). The appellate authority agreed with the submissions made on behalf of the assessee. It was held that sales tax and excise duty were liabilities of the assessee to the Government. They were shown separately from the value of the goods, therefore, they were not included in the "total turnover" for working out the deduction under Section 80HHC.

Aggrieved by the said decision, the Department carried the matter in appeal to the Tribunal. Following the judgment of the Bombay High Court in the case of Commissioner of Income-Tax v. Sudarshan Chemicals Industries Ltd. and another \026 (2000) 245 ITR 769 (Bom.), the Department's appeal stood dismissed. Hence, this civil appeal.

The short point which arises for consideration in this civil appeal is: whether excise duty and sales tax were includible in the "total turnover", which was the denominator in the formula contained in Section 80HHC(3) as it stood in the material time. For the sake of convenience we quote hereinbelow Section 80HHC: "Deduction in respect of profits retained for export business.

80HHC. (1) Where an assessee, being an Indian company or a person (other than a company) resident in India, is engaged in the business of export out of India of any goods or merchandise to which this section applies, there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction of the [profits] derived by the assessee from the export of such goods or merchandise :

Provided that if the assessee, being a holder of an Export House Certificate or a Trading House Certificate (hereafter in this section referred to as an Export House or a Trading House, as the case may be,) issues a certificate referred to in clause (b) of sub-section (4A), that in respect of the amount of the export turnover specified therein, the deduction under this sub-section is to be allowed to a supporting manufacturer, then the amount of deduction in the case of the assessee shall be reduced by such amount which bears to the total profits derived by the assessee from the export of trading goods, the same proportion as the amount of export turnover specified in the said certificate bears to the total export turnover of the assessee in respect of such trading goods.

(1A) Where the assessee, being a supporting manufacturer, has during the previous year, sold goods or merchandise to any Export House or Trading House in respect of which the Export House or Trading House has issued a certificate under the proviso to sub-section (1), there shall, in accordance with and subject to the provisions of this section, be allowed in computing the total income of the assessee, a deduction of the profits derived by the assessee from the sale of goods or merchandise to the Export House or Trading House in respect of which the certificate has been issued by the Export House or Trading House.

(2)(a) This section applies to all goods or merchandise, other than those specified in clause (b), if the sale proceeds of such goods or merchandise exported out of India are received in, or brought into, India by the assessee other than the supporting manufacturer in convertible foreign exchange, within a period of six months from the end of the previous year or, where the Chief Commissioner or Commissioner is satisfied (for reasons to be recorded in writing) that the assessee is, for reasons beyond his control, unable to do so within the said period of six months, within such further period as the Chief Commissioner or Commissioner may allow in this behalf:

(b) This section does not apply to the following goods or merchandise, namely :-

- (i) mineral oil ; and
- (ii) minerals and ores (other than processed minerals and ores specified in the Twelfth Schedule).

Explanation 1.-The sale proceeds referred to in clause (a) shall be deemed to have been received in India where such sale proceeds are credited to a separate account maintained for the purpose by the assessee with any bank outside India with the approval of the Reserve Bank of India.

Explanation 2.-For the removal of doubts, it is hereby declared that where any goods or merchandise are transferred by an assessee to a branch, office, warehouse or any other establishment of the assessee situate outside India and such goods or merchandise are sold from such branch, office, warehouse or establishment, then, such transfer shall be deemed to be export out of India of such goods and merchandise and the value of such goods or merchandise declared in the shipping bill or bill of export as referred to in sub-section (1) of section 50 of the Customs Act, 1962 (52 of 1962), shall, for the purposes of this section, be deemed to be the sale proceeds thereof.

(3) For the purposes of sub-section (1),-

(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 to 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 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 ;

(c) where the export out 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, be 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 to in clause (iia) (not being profits on sale of a licence acquired from any other person), and clauses (iib) and (iic) of section 28, the same proportion as the export turnover bears to the total turnover of the business carried on by the assessee.

Explanation.-For the purposes of this sub-section,-

(a) "adjusted export turnover" means the export turnover as reduced by the export turnover in respect of trading goods ; (b) "adjusted profits of the business" means the profits of the business as reduced by the profits derived from the business of export out of India of trading goods as computed in the manner provided in clause (b) of sub-section (3) ; (c) "adjusted total turnover" means the total turnover of the business as reduced by the export turnover in respect of trading goods ; (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 ; (f) "trading goods" means goods which are not manufactured or processed by the assessee.

(3A) For the purposes of sub-section (1A), profits derived by a supporting manufacturer from the sale of goods or merchandise shall be,-

(a) in a case where the business carried on by the supporting manufacturer consists exclusively of sale of goods or merchandise to one or more Export Houses or Trading Houses, the profits of the business [***] ; (b) in a case where the business carried on by the supporting manufacturer does not consist exclusively of sale of goods or merchandise to one or more Export Houses or Trading Houses, the amount which bears to the profits of the business [***] the same proportion as the turnover in respect of sale to the respective Export House or Trading House bears to the total turnover of the business carried on by the assessee. (4) The deduction under sub-section (1) shall not be admissible unless the assessee furnishes in the prescribed form, along with the return of income, the

report of an accountant, as defined in the Explanation below sub-section (2) of section 288, certifying that the deduction has been correctly claimed in accordance with the provisions of this section:

(4A) The deduction under sub-section (1A) shall not be admissible unless the supporting manufacturer furnishes in the prescribed form along with his return of income,-

(a) the report of an accountant, as defined in the Explanation below sub-section (2) of section 288, certifying that the deduction has been correctly claimed on the basis of the profits of the supporting manufacturer in respect of his sale of goods or merchandise to the Export House or Trading House ; and

(b) a certificate from the Export House or Trading House containing such particulars as may be prescribed and verified in the manner prescribed that in respect of the export turnover mentioned in the certificate, the Export House or Trading House has not claimed the deduction under this section :
Provided that the certificate specified in clause (b) shall be duly certified by the auditor auditing the accounts of the Export House or Trading House under the provisions of this Act or under any other law.

Explanation.-For the purposes of this section,-

(a) "convertible foreign exchange" means foreign exchange which is for the time being treated by the Reserve Bank of India as convertible foreign exchange for the purposes of the Foreign Exchange Regulation Act, 1973 (46 of 1973), and any rules made thereunder;

(aa) "export out of India" shall not include any transaction by way of sale or otherwise, in a shop, emporium or any other establishment situate in India, not involving clearance at any customs station as defined in the Customs Act, 1962 (52 of 1962) ;

(b) "export turnover" means the sale proceeds, received in, or brought into, India by the assessee in convertible foreign exchange in accordance with clause (a) of sub-section (2) of any goods or merchandise to which this section applies and which are exported out of India, but does not include freight or insurance attributable to the transport of the goods or merchandise beyond the customs station as defined in the Customs Act, 1962 (52 of 1962) ;

(ba) "total turnover" shall not include freight or insurance attributable to the transport of the goods or merchandise beyond the customs station as defined in the Customs Act, 1962 (52 of 1962):
Provided that in relation to any assessment year commencing on or after the 1st day of April, 1991, the expression "total turnover" shall have effect as if it also excluded any sum referred to in clauses (iiia), (iiib) and (iiic) of section 28 ;

(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 ;

(c) "Export House Certificate" or "Trading House Certificate" means a valid Export House Certificate or Trading House Certificate, as the case may be, issued by the Chief Controller of Imports and Exports, Government of India ;

(d) "supporting manufacturer" means a person being an Indian company or a person (other than a company) resident in India, manufacturing (including processing) goods or merchandise and selling such goods or merchandise to an Export House or a Trading House for the purposes of export."
 (emphasis supplied)

A brief analysis of the above Section 80HHC of the Act, as amended with effect from 1.4.1992, indicates rationalization of provisions relating to tax concession for export profits. Under Section 80HHC, the exporters were allowed, in the computation of their total income, a deduction of the entire profits derived from exports. During the relevant year, there existed a dual system for computation of export profits. The first method operated in cases where the export was of goods manufactured by the tax payer. In those cases the export profit had to be computed on the basis of the ratio of "export turnover" to "total turnover". In effect, the formula was as follows:

$$80HHC \text{ concession} = \frac{\text{export profits}}{\text{total turnover}} = \text{total profits} \times \frac{\text{export turnover}}{\text{total turnover}}$$

Where the export consisted of goods purchased from third parties (trading goods) there was a second method of computation in which the export profits were to be calculated by deducting from the export turnover, direct and indirect costs attributable to such exports. In that case the formula was as under:

$$80HHC \text{ concession} = \text{export profits} = \text{export turnover} - \text{costs attributable to such exports}$$

By the Finance Act, 1992, one more amendment was made by which the legislature declared that commission received on assignment of export orders, brokerage, interest, rent and items mentioned in Section 28(iia), (iib) and (iic), should not be treated in toto as profits of the business relating to exports and only 10% thereof should be considered as the profit of the business and the balance 90% should not be included in the profits. These amendments took place with effect from 1.4.92, the date from which the dual system of computation of export profits came into effect.

All assessable entities were not eligible for deduction under Section 80HHC of the Act. According to Section 80HHC only an Indian company or a non-company assessee who was the resident in India was eligible for deduction provided he was engaged in the export business of eligible goods. Under the Income Tax Rules, 1962, Form No.10CCAC was prescribed. We quote hereinbelow Annexures A & B to the said Form 10CCAC:
 "FORM NO.10CCAC
 [See rule 18BBA(3)]
 Report under section *80HHC(4)/80HHC(4A) of the Income-tax Act, 1961

1. xxx xxx xxx

2. (a) *I/We certify that the deduction to be claimed by the assessee under sub-section (1) of Section 80HHC of the Income-tax Act, 1961, in respect of the assessment year\005\005\005.is Rs\005\005\005\005\005. which has been determined on the basis of the sale proceeds received by the assessee in convertible foreign exchange. The said amount has been worked out on the basis of the details in Annexure A to this Form.

(b) *I/We certify that the deduction to be claimed by the assessee, as supporting manufacturer, under sub-section (1A) of section 80HHC of the Income-tax Act, 1961, in respect of the assessment year\005\005\005.. is Rs.\005\005\005\005., which has been determined on the basis of sales to Export House/Trading House* made during the year, in respect of which a certificate has been issued by the Export House/Trading House under the proviso to sub-section (1) of section 80HHC of the Income-tax Act, 1961. The said amount has been worked out on the basis of the details in Annexure B to this Form.

3. xxx xxx xxx

Date\005.

Signed
Accountant

Notes: xxx xxx xx

ANNEXURE A

[See paragraph 2(a) of Form No.10CCAC]

Details relating to the claim by the exporter for deduction under section 80HHC of the Income-tax Act, 1961

1. Name of the assessee
2. Assessment year
3. Total turnover of the business
4. Total export turnover
5. Total profits of the business
6. Export turnover in respect of trading goods
7. Direct cost of trading goods exported
8. Indirect cost attributable to trading goods exported
9. Total of 7 + 8
10. Profits from export of trading goods [6 minus 9]
11. Adjusted total turnover (3 minus 6)
12. Adjusted export turnover (4 minus 6)
13. Adjusted profits of the business (5 minus 10)
14. Profits derived by assessee from export of goods or merchandise to which section 80HHC applies, computed under sub-section (3) of section 80HHC
15. Export turnover, deduction in respect of which will be claimed by a supporting manufacturer in accordance with proviso to sub-section (1) of section 80HHC
16. Profit from the export turnover mentioned in item 15 above, calculated in accordance with proviso to sub-section (1) of section 80HHC
17. Deduction under section 80HHC to which the

assessee is entitled (Item 14 minus Item 16)

18. Remarks, if any

ANNEXURE B

[See paragraph 2(b) of Form No.10CCAC]
Details relating to the claim of the supporting
manufacturer for deduction under section
80HHC of the Income-tax Act, 1961

SECTION A

1. Name of the assessee
2. assessment year
3. Total turnover of the business
4. The amount of profit under the head "Profits and gains of business of profession"
5. Total turnover in respect of sale of Export House/Trading House for which certificate is received from Export House/Trading House
6. Profit from the turnover mentioned in item 5 above, computed under sub-section (3A) of section 80HHC
7. Remarks, if any

SECTION B

Details of sale of Export House/Trading House

SL
No.
Name and
address of the
Export
House/Trading
House to
whom goods or
merchandise
were sold
Sale
Invoice
No.
and
date
Sale
price
Invoice No.
and date by
which Export
House/Trading
House has
exported
Date of
certificate
issued by
the
Export
house/
Trading
House

under
clause (b)
of sub-
section
(4A) of
section
80HHC
Amount
of
disclaimer

1
2
3
4
5
6
7

ACTION POINTS

1. Report is to be filed along with return of income.
2. "Total turnover" does not include cash compensatory support, duty drawback and profit on sale of import entitlement licences.
3. "Export turnover" means the sale proceeds (excluding freight and insurance) receivable in convertible foreign exchange \026 See Circular No.564, dated 5-7-1990.
4. Report is to be obtained in respect of each year for which deduction is claimed."

Analysing the above formula, as it stood at the relevant time, it is clear that the amount of deduction under Section 80HHC had to be computed as under:
Business profit x export turnover w total turnover + 90 per cent of export incentive x export turnover w total turnover

Therefore, in the above formula there were three concepts, namely, "business profit", "export turnover" and "total turnover". The first step was to find out the business profit. This was to be done in accordance with the provisions of Section 28 to Section 43 of the Act. Under Section 80HHC the above three export incentives, namely, CCS, duty drawback and profit on sale of import licence, were includible in the "business profits" and, therefore, they were taxable. The Finance Act, 1992, restricted the term "export turnover" to FOB sale proceeds. However, the said Act excluded CCS, Duty Drawback and profit on sale of import entitlement from the term "total turnover".

To sum up, the amount of deduction under Section 80HHC is to be computed as under:

- "1. Profit of the business \026 To find out "profit of the business", the first step is to determine income under the head "Profits and gains of business or profession" [as per section 28(iia), (iib), (iic) this includes three export

incentives. From the income so arrived at, deduct the following:

- a. 90 per cent of export incentive.
- b. 90 per cent of receipts by way of brokerage, commission, interest, rent, charges or other receipts of a similar nature; and
- c. profits of any branch, office, warehouse or any similar establishment of the assessee situate outside India.

2. Export turnover \026 Sale proceeds received in, or brought into India, in convertible foreign exchange within the prescribed time (or within the extended time limit) minus freight and insurance attributable to the transportation of goods/merchandise beyond the customs station is export turnover for this purpose.

3. Total turnover \026 From the turnover (as per books of account) the following should be deducted if these are part of turnover:

- a. freight/insurance attributable to the transport of goods or merchandise beyond customs station in India; and
- b. export incentives.

4. Export incentives - Export incentives are:

- a. profits on sale of a licence granted under the Imports (Control) Order, 1955 made under the Imports and Exports (Control) Act, 1947 [sec.28(iia)];
- b. cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the Government of India [sec.28(iib)];
- c. any duty of customs or excise re-paid or re-payable as drawback to any person against exports under the Customs and Central Excise Duties Drawback Rules, 1971 [sec.28(iic)]."

To simplify the matter we quote hereinbelow paragraph 107.13-3P1 of the Direct Taxes Ready Reckoner by Taxmann for the year 1993-94:

"107.13-3P1 X Ltd. is engaged in manufacturing and/or processing of heavy chemical for export. For the year ending March 31, 1993, the summarized profit and loss account is as follows:

	Rs.		Rs.
Expenses	32,60,000		
Net profit	10,30,000		

42,90,000

Total turnover (of goods exported)	30,50,000
Freight and insurance attributable to transport of goods beyond customs station	2,40,000
Export incentive under Section 28(iia), (iib), (iic)	6,50,000
Brokerage, commission, rent, interest	2,70,000
Profit of foreign branch	80,000
	<u>42,90,000</u>

Other information \026

1. Out of total expenses of Rs.32,60,000 debited to profit and loss account, Rs.51,600 is not deductible by virtue of sections 40 and 40A. The balance amount is, however, deductible.
2. On January 13, 1993, Rs.86,920 is paid on account of excise duty of the previous year 1991-92. Since this amount pertains to the previous year 1991-92, it has not been debited to the aforesaid profit and loss account.
3. The company has received Rs.24,90,000 in convertible foreign exchange till September 30, 1993. The company's application for obtaining extension of time under section 80HHC has been rejected by the Commissioner.
4. During the previous year 1992-93, the company gets a short-term gain of Rs.20,000.
5. The company is entitled for deduction under section 80-I.

Compute the net income of the company for the assessment year 1993-94.

Profits and gains of business of profession:

Rs.	
Net profit as P & L account	
Add: Amount not deductible by virtue of secs.40 and 40A	
10,30,000	
51,600	
Less: Excise duty of 1991-92, deductible by virtue of section 43B [see para 49.10]	
10,81,600	
(-) 86,920	
Business income (under section 28)	
Capital gains	
9,94,680	
20,000	
Gross total income	
10,14,680	
Less: Deduction	
Under section 80HHC [see Note]	

Under section 80-I [i.e., 25% of Rs.9,94,680]
 Net income (rounded off)

5,48,355
 2,48,670
 2,17,660

Note: Computation of deduction under section 80HHC

1. Profit of the business - It will be calculated as follows:
 Income under the head "Profits and gains of business or
 profession"

	9,94,680
Less:	
90% of export incentives (i.e., 90% of Rs.6,50,000)	
90% of brokerage, commission, rent and interest (i.e., 90% of Rs.2,70,000)	
Profit of the foreign branch	
Profit of the business	
(-)	5,85,000
(-)	2,43,000
(-)	80,000
	86,680

2. Export turnover \026 It is Rs.24,90,000 being the
 brought to India (within the time limit), in the
 convertible foreign exchange.

3. Total turnover \026 It is Rs.30,50,000.

4. Export incentive \026 Export incentive is Rs.6,50,000.

Amount of deduction is as follows:

(Rs.86,680 x Rs.24,90,000 w Rs.30,50,000) + (90% of
 Rs.6,50,000 x Rs.24,90,000 w Rs.30,50,000) =

Rs. 5,48,355.

107.13-4 ASSESSEE WHOSE EXPORTS GOODS MANUFACTURED/PROCESSED BY OTHERS \026 HOW TO FIND OUT DEDUCTION - This category covers those assessees who export goods manufactured/processed by others:

107.13-4a Conditions \026 In order to get deduction one has to satisfy conditions specified in paras 107.13-3a.

107.13-4b Amount of deduction \026 Deduction under section 80HHC will be determined as under:
(Export turnover¹ minus direct cost² minus indirect cost³) + (90 per cent of export incentive⁵ x Export turnover w total turnover)

1. Export turnover \026 Sale proceeds received in, or brought into India in, convertible foreign exchange within the prescribed time (or within the extended time limit) minus freight and insurance attributable to the transportation of goods/merchandise beyond the customs station, is export turnover for this purpose.
2. Direct cost \026 Under Explanation (d) to section 80HHC(3), "direct costs" comprises the following:
 - a. the purchase price of the goods, and
 - b. costs directly attributable to the trading goods exported out of India.

Purchase price \026 under the accepted principles of accounting, purchase price would mean invoice value, including taxes and duties, as reduced by (i) value of any purchase returns, (ii) trade discounts and rebates, if any, allowed, and (iii) value of any incentives which is passed on to the seller. Similarly, sales tax set-off available in respect of exports can also be reduced from purchase costs. However, cash discount obtained any other rebate or set-off available after the end of the relevant previous year cannot be reduced from purchase cost. If, as per the terms of the contract, any export incentives are passed on to the seller, they would have an effect on purchase price and to that extent purchase cost would be lower.

Costs directly attributable to trading goods \026 These costs would generally embrace, apart from the purchase cost and related costs, such other costs which have been incurred either in relation to the purchase, or in relation to the transportation or storage of the goods prior to their export, or in relation to the movement of goods from the exporter's godown, premises or warehouse to the customs station. The use of the word "directly" signifies that there should be a proximate connection between the costs and the purchase of the trading goods. In other words, they should not be "overhead costs".

3. Indirect cost \026 Under Explanation (e) to section 80HHC(3), the term "indirect costs" means costs (not being direct costs) allocated in the ratio of the export turnover in respect of the trading goods to the total turnover. In other

words, indirect cost may be computed as under: (Total cost minus direct cost) x Export turnover in respect of trading goods / Total turnover.

4. Total turnover \026 From the turnover (as per books of account) the following should be deducted if these are part of turnover:

- a. freight/insurance attributable to the transport of goods or merchandise beyond customs station in India; and
- b. export incentives.

5. Export incentives \026 Export incentives are:

- a. profits on sale of a licence granted under the Imports (Control) Order, 1955 made under the Imports and Exports (Control) Act, 1947 [sec.28(iia)];
- b. cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the Government of India [sec.28 (iib)];
- c. any duty of customs or excise re-paid or re-payable as drawback to any person against exports under the Customs and Central Excise Duties Drawback Rules, 1971 [sec.28(iic)]"

The above examples show that the formula under Section 80HHC was very simple as far as it related to the sole business of exports. The formula became complicated in cases of composite business. In the case of direct exporter there were three categories of assesseees \026 (i) an assessee who exported goods manufactured by him; (ii) an assessee who did not export goods manufactured by him but exported goods manufactured by others; and (iii) an assessee who exported manufactured goods as well as trading goods. The formula became complicated in the case of the third category. It also became complicated in the cases of an assessee who did not directly export goods but supplied goods to an Export House/Trading House for the purpose of export (subordinate manufacturer).

The principal reason for enacting the above formula was to disallow a part of 80HHC concession when the entire deduction claimed could not be regarded as relatable to exports. Therefore, while interpreting the words "total turnover" in the above formula in Section 80HHC one has to give a schematic interpretation to that expression. There is one more reason for giving schematic interpretation. The various amendments to Section 80HHC show that receipts by way of brokerage, commission, interest, rent etc. do not form part of business profits as they have no nexus with the activity of exports. If interest or rent was not regarded by the legislature as business profits, the question of treating the same as part of the total turnover in the above formula did not arise. In fact, Section 80 HHC had to be amended several times since the formula on several occasions gave a distorted figure of export profits when receipts like interest, rent, commission etc. which did not have the element of turnover got included in the profit and loss account and consequently became entitled to

deduction. This was clarified by the above amendment to Section 80HHC commencing from 1.4.92. The said amendment made it clear that though commission and interest emanated from exports, they did not involve any element of turnover and merely for the reason that commission, interest, rent etc. were included in the profit and loss account, they did not become eligible to deduction. We have to give purposeful interpretation to the above section. The said section is entirely based on the formula. The amendments from time to time indicate that they became necessary in order to make the formula workable. Hence, we have to give schematic interpretation to Section 80HHC of the Act.

Shri P.P. Malhotra, learned senior counsel appearing for the Department (appellant), submitted that one has to give plain and unambiguous meaning to the word "turnover" in the above formula; that there was no need to call for any rule of interpretation or external aid to interpret the said word; that having regard to the plain words of the section, excise duty and sales tax ought to have been included in the "total turnover". Learned counsel submitted that the word "turnover" even in the ordinary sense would include the above two items. Learned counsel urged that the formula should be read strictly. In this connection, he pointed out that the legislature had expressly excluded items of freight and insurance and not sales tax and excise duty from the said definition. It was urged that while construing a taxing statute strict interpretation should be given by the Courts. It was urged that the definition of the words "total turnover" did not include freight/insurance. He urged that since the legislature had excluded only insurance and freight, it was not open to the courts to exclude excise duty and sales tax from the concept of "total turnover" in the said formula. He contended that the word "turnover" referred to the aggregate amount for which the goods were sold and since sales tax and excise duty formed part of the value of the goods, the said two items were includible in the definition of the words "total turnover". In this connection, learned counsel placed reliance on the judgment of the Supreme Court in the case of M/s. Chowringhee Sales Bureau (supra). Reliance was also placed on "The Law and Practice of Income Tax" by Kanga and Palkhivala (eighth edition) at page 123. In support of the contention that a tax or duty is part of the dealer's trading/business receipts, even if the tax or duty is charged separately or credited to a separate account. Reliance was also placed on the judgment of the King's Bench Division in the case of Paprika, Ltd., and Another v. Board of Trade - (1944) 1 All E.R. 372, in which it has been held that wherever a sale attracts purchase tax, that tax affects the price which the seller who is liable to pay the tax demands, but it does not cease to be the price which the buyer has to pay even if the price is expressed as cost x + purchase tax. Reliance was also placed on the judgment of the Court of Appeal in the case of Love v. Norman Wright (Builders), Ltd. \026 (1944) 1 All E.R. 618, in which it has been held that if a seller quotes a price of 'x' + purchase tax, the buyer has to pay the amount of the tax as part of the price and since the tax is charged on the wholesale value of the goods the tax element has to be taken into account. It was urged that one has to give strict interpretation to the word "turnover". It was urged that

there was no question of giving purposeful interpretation to the word "turnover" in the said Section 80HHC of the Act. It was urged that the legislature had used the expression "total turnover" from which it became clear that the said expression referred to the aggregate amount for which the goods were sold and since the above two items formed part of the value of the goods, they were includible in the "total turnover". Learned counsel urged that there was no merit in the contention advanced on behalf of the assessee that excise duty was the liability of the assessee to the Government and, therefore, it was not includible in the total turnover. Learned counsel urged that there was no merit in the contention advanced on behalf of the assessee that the components of "export turnover" and "total turnover" should be the same in the above formula. Learned counsel submitted that the formula would become unworkable if the components in the "export turnover" and the components in the "total turnover" are the same. Learned counsel submitted that there was no merit in the argument advanced on behalf of the assessee that excise duty and sales tax did not form part of trading receipts. Learned counsel submitted that there was no merit in the contention of the assessee that the expression "business profits" in Section 80HHC did not include receipts which did not emanate for exports and, therefore, such receipts did not constitute an element of turnover.

We do not find any merit in the above contentions advanced on behalf of the Department. It is important to note that tax under the Act is upon income, profits and gains. It is not a tax on gross receipts. Under Section 2(24) of the Act the word "income" includes profits and gains. The charge is not on gross receipts but on profits and gains. The charge is not on gross receipts but on profits and gains properly so-called. Gross receipts or sale proceeds, however, include profits. According to "The Law and Practice of Income Tax" by Kanga and Palkhivala, the word "profits" in Section 28 should be understood in normal and proper sense. However, subject to special requirements of the income tax, profits have got to be assessed provided they are real profits. Such profits have to be got to be ascertained on ordinary principles of commercial trading and accounting. However, the income tax has laid down certain rules to be applied in deciding how the tax should be assessed and even if the result is to tax as profits what cannot be construed as profits, still the requirements of the income tax must be complied with. Where a deduction is necessary in order to ascertain the profits and gains, such deductions should be allowed. Profits should be computed after deducting the expenses incurred for business though such expenses may not be admissible expressly under the Act, unless such expenses are expressly disallowed by the Act [SEE: page 455 of "The Law and Practice of Income Tax" by Kanga and Palkhivala]. Therefore, schematic interpretation for making the formula in Section 80HHC workable cannot be ruled out. Similarly, purposeful interpretation of Section 80HHC which has undergone so many changes cannot be ruled out, particularly, when those legislative changes indicate that the legislature intended to exclude items like commission and interest from deduction on the ground that they did not possess any element of "turnover" even though commission and interest

emanated from exports. We have to read the words "total turnover" in Section 80HHC as part of the formula which sought to segregate the "export profits" from the "business profits". Therefore, we have to read the formula in entirety. In that formula the entire business profits is not given deduction. It is the business profit which is proportionately reduced by the above fraction/ratio of export turnover w total turnover which constitute 80HHC concession (deduction). Income in the nature of "business profits" was, therefore, apportioned. The above formula fixed a ratio in which "business profits" under Section 28 of the Act had to be apportioned. Therefore, one has to give weightage not only to the words "total turnover" but also to the words "export turnover", "total export turnover" and "business profits". That is the reason why we have quoted hereinabove extensively the illustration from the Direct Taxes (Income tax) Ready Reckoner of the relevant word. In the circumstances, we cannot interpret the words "total turnover" in the above formula with reference to the definition of the word "turnover" in other laws like Central Sales Tax or as defined in accounting principles. Goods for export do not incur excise duty liability. As stated above, even commission and interest formed a part of the profit and loss account, however, they were not eligible for deduction under Section 80HHC. They were not eligible even without the clarification introduced by the legislature by various amendments because they did not involve any element of turnover. Further, in all other provisions of the income tax, profits and gains were required to be computed with reference to the books of accounts of the assessee. However, as can be seen from the Income Tax Rules and from the above Form No.10CCAC in the case of deduction under Section 80HHC a report of the auditor certifying deduction based on export turnover was sufficient. This is because the very basis for computing Section 80HHC deduction was "business profits" as computed under Section 28, a portion of which had to be apportioned in terms of the above ratio of export turnover to total turnover. Section 80HHC(3) was a beneficial section. It was intended to provide incentives to promote exports. The incentive was to exempt profits relatable to exports. In the case of combined business of an assessee having export business and domestic business the legislature intended to have a formula to ascertain export profits by apportioning the total business profits on the basis of turnovers. Apportionment of profits on the basis of turnover was accepted as a method of arriving at export profits. This method earlier existed under Excess Profits Tax Act, it existed in the Business Profits Tax Act. Therefore, just as commission received by an assessee is relatable to exports and yet it cannot form part of "turnover", excise duty and sales tax also cannot form part of the "turnover". Similarly, "interest" emanates from exports and yet "interest" does not involve an element of turnover. The object of the legislature in enacting Section 80HHC of the Act was to confer a benefit on profits accruing with reference to export turnover. Therefore, "turnover" was the requirement. Commission, rent, interest etc. did not involve any turnover. Therefore, 90% of such commission, interest etc. was excluded from the profits derived from the export. Therefore, even without the clarification such items did not form part of the formula in Section

80HHC(3) for the simple reason that it did not emanate from the "export turnover", much less any turnover. Even if the assessee was an exclusive dealer in exports, the said commission was not includible as it did not spring from the "turnover". Just as interest, commission etc. did not emanate from the "turnover", so also excise duty and sales tax did not emanate from such turnover. Since excise duty and sales tax did not involve any such turnover, such taxes had to be excluded. Commission, interest, rent etc. do yield profits, but they do not partake of the character of turnover and, therefore, they were not includible in the "total turnover". The above discussion shows that income from rent, commission etc. cannot be considered as part of business profits and, therefore, they cannot be held as part of the turnover also. In fact, in Civil Appeal No.4409 of 2005, the above proposition has been accepted by the A.O. [See: page no.24 of the paper book], if so, then excise duty and sales tax also cannot form part of the "total turnover" under Section 80HHC(3), otherwise the formula becomes unworkable. In our view, sales tax and excise duty also do not have any element of "turnover" which is the position even in the case of rent, commission, interest etc. It is important to bear in mind that excise duty and sales tax are indirect taxes. They are recovered by the assessee on behalf of the Government. Therefore, if they are made relatable to exports, the formula under Section 80HHC would become unworkable. The view which we have taken is in the light of amendments made to Section 80HHC from time to time.

Before concluding we may state that profits are of three types, namely, book-profits, statutory profits and actual profits. The amendments to Section 80HHC(3) indicate exclusion of book profits. For example, commission, interest, etc. do form part of the profit and loss account but for the purposes of calculation of profits derived from local sales and exports, they stand excluded. The difficulty arises because the formula is based on the Hybrid System of Profits, namely, actual and statutory profits. Therefore, this judgment should be read in the context of the above parameters. Our reasoning in this judgment is confined to the workability of the formula in Section 80HHC(3) of the Act as it stood at the material time.

For the above reasons, we see no merit in these appeals filed by the Department and, accordingly, they are dismissed with no order as to costs.