REPORTABLE

IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 4822 OF 2022
(@SLP (C) NO. 17539 OF 2016)

M/s. Saraf Exports …Appellant(s)

Versus

Commissioner of Income Tax,
Jaipur-III …Respondent(s)

J U D G M E N T

M.R. SHAH, J.

1. Feeling aggrieved and dissatisfied with the impugned judgment and order passed by the High Court of Judicature for Rajasthan at Jaipur dated 04.02.2016 in D.B. Income Tax Appeal No. 7 of 2014 by which the High Court has allowed the said appeal preferred by the Revenue and has held that the assessee is not entitled to the deduction under Section 80-IB of the Income Tax Act, 1961 (hereinafter referred to as "Act, 1961") with respect to the receipts under the Duty Drawback Scheme

(hereinafter referred to as “Duty Drawback”) and on transfer of Duty Entitlement Pass Book Scheme (hereinafter referred to as “DEPB”), the assessee has preferred the present appeal.

2. The facts leading to the present appeal in nutshell are as under:-

2.1 The assessee, a partnership firm, was engaged in the business of manufacturing and exporting wooden handicraft items. For the Assessment Year (A.Y.) 2008-09, the assessee filed its return on 30.09.2008 declaring its income as nil, claiming deduction of Rs. 70,197/- on account of DEPB and of Rs. 76,27,636/- on account of receipts under the Duty Drawback.

2.2 The assessee credited the receipts of the aforesaid amounts into the Profit & Loss Account and claimed the same as “Profit / gains of business / profession” under Sections 28(iiic) and 28(iiib) of the Act, 1961. The assessee was issued a notice under Section 143(2) of the Act, 1961.

2.3 By order dated 24.11.2010, the Deputy Commissioner disallowed the deductions as claimed. The

order of the Deputy Commissioner disallowing the exemption as claimed, came to be upheld by the Commissioner of Income Tax (Appeals). However, the Income Tax Appellate Tribunal (ITAT) allowed the appeal preferred by the assessee *vide* order dated 17.12.2013 by *inter alia* observing that the decision of this Court in the case of **Liberty India Vs. Commissioner of Income Tax, (2009) 9 SCC 328 : (2009) 317 ITR 218 (SC)** can be said to be per incuriam and allowed the deductions as claimed on the receipts of amount under DEPB Scheme and Duty Drawback Scheme.

2.4 By the impugned judgment and order and relying upon the decision of this Court in the case of **Liberty India (supra)** and the decision of this Court in the case of **Commissioner of Income Tax, Karnataka Vs. Sterling Foods, Mangalore (1999) 4 SCC 98**, the High Court has allowed the appeal preferred by the Revenue and has restored the order passed by the Deputy Commissioner disallowing the deductions claimed under Section 80-IB of the Act, 1961. The impugned judgment and order passed by the High Court is the subject matter of the present appeal.

3. Learned counsel appearing on behalf of the assessee has heavily relied upon the decision of this Court in the case of **Commissioner of Income Tax Vs. Meghalaya Steels Limited, (2016) 6 SCC 747 : (2016) 383 ITR 217 (SC)**,

3.1 It is submitted that the meaning of "derived from" under Section 80-IB as laid down in **Liberty India (supra)** has been widened by this Hon'ble Court in the case of **Meghalaya Steels Limited (supra).**

3.2 It is further submitted that the conclusion of **Liberty India (supra)** is based on the finding that "derived from" under Section 80-IB requires a "first degree" connection with the business of the industrial undertaking whereas the source of DEPB / Duty Drawback are incentives given under the Duty Exemption Remission Scheme / Section 75 of the Customs Act, 1962. That applying the test of "first degree", this Court in the case of **Liberty India (supra)** held that receipts from DEPB / Duty Drawback cannot be deducted under Section 80-IB.

3.3 It is next submitted that, however, subsequently, in the case of **Meghalaya Steels Limited (supra)**, the issue before this Court was whether transport, interest and

power subsidy granted by the Government were entitled to be deducted under Section 80-IB and this Hon'ble Court has held that receipts of amount on the aforesaid subsidies were entitled to be deducted under Section 80-IB. It is submitted that in the said case, before this Court, the Revenue relied upon **Liberty India (supra)** to contend that the source of subsidies was the Government and therefore, it could not be considered as having a direct nexus / close connection with the business of the assessee. It is submitted that, however, this Court has rejected the said contention and held that the fact that the Government is the "immediate source" of the subsidies is not relevant so long as the subsidies reimbursed, wholly or partially, costs actually incurred by the assessee in manufacturing or selling of the products, because, the profits or gains referred to in Section 80-IB means net profit, i.e., profit derived after deduction of manufacturing cost and selling cost.

3.4 It is contended that this Court specifically relied on Section 28(iii)(b) and reiterated that any cash assistance received from the Government against exports under any Scheme is chargeable to income tax under the head of "Profit or gains of business or profession". That this Court approved the decision of the Delhi High Court in the case

of **Commissioner of Income Tax Vs. Dharam Pal Prem Chand Ltd., (2009) 317 ITR 353 (Del)** holding that the refund of excise duty should not be excluded in arriving at the profit derived from business for the purpose of claiming deduction under Section 80-IB.

3.5 It is further contended that therefore, applying the law laid down by this Court in the case of **Meghalaya Steels Limited (supra)**, the expression "Profit or gains derived from any business" under Section 80-IB will include any reimbursement of cost even if the immediate reimbursement of such source is the Government or its policy.

3.6 It is submitted by the learned counsel appearing on behalf of the assessee that in the case of **Topman Exports Vs. Commissioner of Income Tax, Mumbai, (2012) 3 SCC 593**, it is observed and held that the DEPB / Duty Drawback are relatable to cost of manufacture and has a direct nexus with the cost of imports. That the said view is in consonance with the view taken earlier in the case of **B. Desraj Vs. Commissioner of Income Tax, Salem, (2010) 14 SCC 510**, which held that the Duty

Drawback was in the nature of cash assistance under Section 28(iii)(b).

3.7 It is next contended that in the case of **Topman Exports (supra)**, it is held that the DEPB is assistance given by the Government to an exporter to pay customs duty on its imports and it is receivable once exports are made and an application under the DEPB Scheme is made. That this Court has also held that DEPB also has a cost element in so much as the cost of acquiring it is not nil because it is acquired by paying customs duty on the import content of the export product. It is submitted that the decision of this Court in the case of **Topman Exports (supra)** has been subsequently followed in the cases of **ACG Associated Capsules Private Limited Vs. Commissioner of Income Tax, Central-IV, Mumbai (2012) 3 SCC 321; Vikas Kalra Vs. Commissioner of Income Tax – VII, New Delhi, (2012) 3 SCC 611** and **Nissan Export Vs. Commissioner of Income Tax, (2014) 14 SCC 152**.

3.8 It is submitted that, therefore, and in view of the development of law in **Meghalaya Steels Limited (supra)** and the **Topman Exports (supra)** DEPB / Duty Drawback

are “profits and gains derived from any business” within the purview of Section 80-IB.

3.9 It is averred by the learned counsel appearing on behalf of the assessee that various High Courts have taken the view that the “immediate source” of the income is not determinative.

4. Shri Balbir Singh, learned ASG while opposing the present appeal has vehemently submitted that the issue involved in the present appeal is squarely covered against the assessee in view of the decision of this Court in the case of **Liberty India (supra)** and **Sterling Foods, Mangalore (supra)**. It is submitted that therefore, relying upon and following the decisions of this Hon’ble Court in the aforesaid two decisions, the High Court has not committed any error in holding that the assessee is not entitled to the deductions under Section 80-IB on the amount received by way of DEPB and Duty Drawback Schemes.

4.1 Insofar as the reliance placed by the assessee upon the decision of this Court in the case of **Meghalaya Steels Limited (supra)** is concerned, it is submitted that

in the case of **Meghalaya Steels Limited (supra)**, this Court has not disagreed with or disapproved the decision in the case of **Liberty India (supra)** or **Sterling Foods, Mangalore (supra).** It is submitted that even otherwise, the said decisions shall not be applicable in case of receipt of the amount under DEPB and Duty Drawback Schemes as the same cannot be said to be an income that falls under the head "profits and gains of business or profession".

4.2 Shri Balbir Singh, learned ASG has taken us through the scheme of Section 28 and Section 80-IB of the Act, 1961. It is submitted that insofar as Section 28 is concerned, it speaks about the income that falls under the head of "profit and gains of business or profession". That earlier there used to be a dispute regarding the receipt by way of incentives from the Government being in the nature of cash assistance, Duty Drawback, profits on transfer of DEPB Scheme, as to whether these receipts were capital receipts or revenue receipts and would these be taxable. That to put an end to the uncertainty, the legislature by way of inserting clauses (iiia), (iiib), (iiic), (iiid) and (iiie) in Section 28 has made the said incentives taxable under the head of profits and gains of business and profession.

4.3 It is further submitted that Section 80-IB provides for deductions in respect of profits and gains from certain 'industrial undertakings' other than infrastructure development undertakings. That this Section applies to the following "industrial undertakings" which are eligible for deduction under the said Section:-

a) Small scale industries into manufacturing and production
b) Undertaking in industrially backward state and North-Eastern Region
c) Ship
d) Hotels
e) Cold storage plants and cold chains
f) Mineral oil and natural gas
g) Housing projects
h) Scientific research and development
i) Processing, preservation and packaging of food items
j) Multiplex theatre
k) Convention centre
l) Hospitals in rural and specified areas

4.4 It is next submitted that as per the language used in Section 80-IB with regard to calculating the deduction, the deduction would be applicable on "any profits and gains 'derived from' any business referred to in…" included in the gross total income of the assessee. That the most

important thing to be considered while interpreting the said section is that the words used are “derived from” and not “attributable to”. That the words “attributable to” in the given clause have been given a wider connotation as opposed to the words “derived from” which have been interpreted to be confined to “first degree sources”. It is submitted that the words “derived from” have been given a restrictive interpretation.

4.5 It is contended that the connotation “derived from” used in Section 80-IB has to be read to be unit specific and cannot be read as “standalone” since the words used in the clauses of Section 80-IB are “industrial undertaking”. That the core issue therefore, pertains to the interpretation of the words “derived from” in Section 80-IB of the Act. It is submitted that on a fair reading of Section 80-IB read with Section 28 and on true interpretation of Section 80-IB, the DEPB and Duty Drawback Schemes cannot be said to be deriving the income from the business undertaking and, therefore, deduction under Section 80-IB on such receipt of the Duty Drawback shall not be allowable as a deduction.

4.6 It is submitted that in the case of **Sterling Foods, Mangalore (supra)**, while adjudicating the issue of

whether on earning of import entitlements under an export promotion scheme of the Central Government, deduction under Section 80HH would be allowable or not, this Court gave the words “derived from” used in Section 80HH a restricted interpretation and it was observed that since the words “derived from” have been used, it shall suggest to go to the source of such profits and gains.

4.7 It is submitted that in the case of **Liberty India (supra)**, this Court has considered in detail, deduction in respect of profits and gains “derived from”. That in the said decision, this Court has discussed the DEPB and Duty Drawback and thereafter has held that the Duty Drawback and DEPB benefits cannot be credited against the cost of manufacture of goods debited in the profit and loss account for the purpose of Section 80-IB as such remissions would constitute independent source of income, beyond the first degree nexus between profits and the industrial undertaking.

4.8 Insofar as the reliance placed by the assessee upon the decision of this Court in the case of **Meghalaya Steels Limited (supra)** is concerned, it is submitted that the question in **Meghalaya Steels Limited (supra)**

pertained to three subsidies, namely, a) Transport Subsidy, b) Interest Subsidy and c) Power Subsidy. That this Court held that since these subsidies directly affect the cost of manufacturing, they have a direct nexus between the profits and gains of the undertaking. Since these subsidies have a direct nexus, they can be said to be derived from the industrial undertaking. It is submitted that though in the said decision, this Court has not held the decision in the case of **Liberty India (supra)** to be bad in law, in para 20, this Court has also observed that since if there is no export, there is no DEPB entitlement. Therefore, its relation to manufacture of a product and/or sale within India is not proximate or direct but is one step removed. That it is observed that the object behind the DEPB entitlement, as has been held by this Court, is to neutralise the incidence of customs duty payment on the import content of the export product. In such a scenario, it cannot be said that such duty exemption scheme is derived from profits and gains made by the industrial undertaking or business itself. It is submitted that, therefore, in light of the above, the decision in the case of **Meghalaya Steels Limited (supra)** shall not be applicable to the present matter as it pertains to the above-mentioned subsidies only. It is next submitted that

though binding, the ITAT did not follow the decisions of this Court in the case of **Liberty India (supra)** and **Sterling Foods, Mangalore (supra)**, and, therefore, the High Court has rightly set aside the order passed by the ITAT following the decisions of this Court in the case of **Liberty India (supra)** and **Sterling Foods, Mangalore (supra)**. It is submitted that therefore, the impugned judgment and order passed by the High Court is not required to be interfered with.

4.9 Making above submissions, it is prayed that the present appeal be dismissed.

5. Heard the learned counsel for the respective parties at length.

6. The short question, which is posed for consideration of this Court is:-

> Whether on the income amount received / profit from DEPB and Duty Drawback Schemes, the assessee is entitled to deduction under Section 80-IB of the Income Tax Act, 1961 and whether such an income can be said to be an income “derived from” industrial undertaking?

7. While considering the aforesaid issue/question, relevant portion of Section 28 and Section 80-IB are required to be referred to, which are as under:-

> "**28. Profits and gains of business or profession**.—The following income shall be chargeable to income tax under the head "Profits and gains of business or profession", —
>
> XXXXXXXX
>
> (*iii-a*) profits on sale of a licence granted under the Imports (Control) Order, 1955, made under the Imports and Exports (Control) Act, 1947 (18 of 1947);
>
> (*iii-b*) cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the Government of India;
>
> (*iii-c*) any duty of customs or excise repaid or repayable as drawback to any person against exports under the Customs and Central Excise Duties Drawback Rules, 1971;
>
> (*iii-d*) any profit on the transfer of the Duty Entitlement Pass Book Scheme, being the Duty Remission Scheme under the export and import policy formulated and announced under Section 5 of the Foreign Trade (Development and Regulation) Act, 1992 (22 of 1992);
>
> (*iii-e*) any profit on the transfer of the Duty Free Replenishment Certificate, being the

Duty Remission Scheme under the export and import policy formulated and announced under Section 5 of the Foreign Trade (Development and Regulation) Act, 1992 (22 of 1992);

XXXXXXXX"

"**80-IB. Deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings**.—(1) Where the gross total income of an assessee includes any profits and gains derived from any business referred to in sub-sections (3) to (11), (11-A) and (11-B) (such business being hereinafter referred to as the eligible business), 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 from such profits and gains of an amount equal to such percentage and for such number of assessment years as specified in this section.

(2) This section applies to any industrial undertaking which fulfils all the following conditions, namely:—

(*i*) it is not formed by splitting up, or the reconstruction, of a business already in existence:

Provided that this condition shall not apply in respect of an industrial undertaking which is

formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such industrial undertaking as is referred to in Section 33-B, in the circumstances and within the period specified in that section;

(*ii*) it is not formed by the transfer to a new business of machinery or plant previously used for any purpose;

(*iii*) it manufactures or produces any article or thing, not being any article or thing specified in the list in the Eleventh Schedule, or operates one or more cold storage plant or plants, in any part of India:

Provided that the condition in this clause shall, in relation to a small-scale industrial undertaking or an industrial undertaking referred to in sub-section (4) shall apply as if the words 'not being any article or thing specified in the list in the Eleventh Schedule' had been omitted.

Explanation 1.—For the purposes of clause (*ii*), any machinery or plant which was used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose, if the following conditions are fulfilled, namely:—

(a) such machinery or plant was not, at any time previous to the date of the installation by the assessee, used in India;

(b) such machinery or plant is imported into India from any country outside India; and

(c) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of this Act in computing the total income of any person for any period prior to the date of the installation of the machinery or plant by the assessee.

Explanation 2.—Where in the case of an industrial undertaking, any machinery or plant or any part thereof previously used for any purpose is transferred to a new business and the total value of the machinery or plant or part so transferred does not exceed twenty per cent of the total value of the machinery or plant used in the business, then, for the purposes of clause (*ii*) of this sub-section, the condition specified therein shall be deemed to have been complied with;

(*iv*) in a case where the industrial undertaking manufactures or produces articles or things, the undertaking employs ten or more workers in a manufacturing process carried on with the aid of power, or employs twenty or more workers in a manufacturing process carried on without the aid of power.

(3) The amount of deduction in the case of an industrial undertaking shall be twenty-five per cent (or thirty per cent where the assessee is a company), of the profits and gains derived from such industrial undertaking for a period of ten consecutive assessment years (or twelve consecutive assessment years where the assessee is a cooperative society) beginning with the initial assessment year subject to the fulfilment of the following conditions, namely:—

(*i*) it begins to manufacture or produce, articles or things or to operate such plant or plants at any time during the period beginning from the 1st day of April, 1991 and ending on the 31st day of March, 1995 or such further period as the Central Government may, by notification in the Official Gazette, specify with reference to any particular undertaking;

(*ii*) where it is an industrial undertaking being a small-scale industrial undertaking, it begins to manufacture or produce articles or things or to operate its cold storage plant not specified in sub-section (4) or sub-section (5) at any time during the period beginning on the 1st day of April, 1995 and ending on the 31st day of March, 2002.

(4) The amount of deduction in the case of an industrial undertaking in an industrially backward State specified in the Eighth Schedule shall be hundred per cent of the profits and gains derived from such industrial

undertaking for five assessment years beginning with the initial assessment year and thereafter twenty-five per cent (or thirty per cent where the assessee is a company) of the profits and gains derived from such industrial undertaking:

Provided that the total period of deduction does not exceed ten consecutive asssessment years (or twelve consecutive assessment years where the assessee is a cooperative society) subject to fulfilment of the condition that it begins to manufacture or produce articles or things or to operate its cold storage plant or plants during the period beginning on the 1st day of April, 1993 and ending on the 31st day of March, *2004*:

Provided further that in the case of such industries in the North-Eastern Region, as may be notified by the Central Government, the amount of deduction shall be hundred per cent of profits and gains for a period of ten assessment years, and the total period of deduction shall in such a case not exceed ten assessment years:

Provided also that no deduction under this sub-section shall be allowed for the assessment year beginning on the 1st day of April, 2004 or any subsequent year to any undertaking or enterprise referred to in sub-section (2) of Section 80-IC.

Provided also that in the case of an industrial undertaking in the State of Jammu and Kashmir, the provisions of the first proviso shall have effect as if for the figures, letters and words "31st day of March, 2004", the figures, letters and words "31st day of March, 2012" had been substituted:

Provided also that no deduction under this sub-section shall be allowed to an industrial undertaking in the State of Jammu and Kashmir which is engaged in the manufacture or production of any article or thing specified in Part C of the Thirteenth Schedule.

(5) The amount of deduction in the case of an industrial undertaking located in such industrially backward districts as the Central Government may, having regard to the prescribed guidelines, by notification in the Official Gazette, specify in this behalf as industrially backward district of category 'A' or an industrially backward district of category 'B' shall be,—

(*i*) hundred per cent of the profits and gains derived from an industrial undertaking located in a backward district of category 'A' for five assessment years beginning with the initial assessment year and thereafter, twenty-five per cent (or thirty per cent where the assessee is a company) of the profits and gains of an industrial undertaking:

Provided that the total period of deduction shall not exceed ten consecutive assessment years or where the assessee is a cooperative society, twelve consecutive assessment years:

Provided further that the industrial undertaking begins to manufacture or produce articles or things or to operate its cold storage plant or plants at any time during the period beginning on the 1st day of October, 1994 and ending on the 31st day of March, *2004*;

(*ii*) hundred per cent of the profits and gains derived from an industrial undertaking located in a backward district of category 'B' for three assessment years beginning with the initial assessment year and thereafter, twenty-five per cent (or thirty per cent where the assessee is a company) of the profits and gains of an industrial undertaking:

Provided that the total period of deduction does not exceed eight consecutive assessment years (or where the assessee is a cooperative society, twelve consecutive assessment years):

Provided further that the industrial undertaking begins to manufacture or produce articles or things or to operate its cold storage plant or plants at any time during the period beginning on the 1st day of October, 1994 and ending on the 31st day of March, *2004*.

XXXXXXXX”

7.1 Thus, as per Sections 28(iiid) and (iiie) any profit on the transfer of the Duty Drawback and on transfer of DEPB Schemes, etc., shall be chargeable to income tax under the head “Profits and gains of business or profession”. It appears that earlier, there used to be a dispute regarding the receipt by way of incentives from the Government being in the nature of cash assistance, duty drawback, profits on transfer of DEPB Scheme, etc., i.e., as to whether these receipts were capital receipt or revenue receipt and would thus, be taxable. However, thereafter, and in order to put an end to the dispute, the legislature by way of inserting clauses 28 (iiia), (iiib), (iiic), (iiid) and (iiie) has made the said incentives taxable under the head of “profits and gains of business and profession”.

7.2 Section 80-IB provides for deductions in respect of profits and gains from certain industrial undertakings. Therefore, as such for claiming deductions under Section 80-IB, it must be on the “profits and gains derived from industrial undertakings” mentioned in Section 80-IB. An identical question came to be considered by this Court and, more particularly, with respect to the profit from

DEPB and Duty Drawback Schemes, in the case of **Liberty India (supra)**.

7.3 After taking into consideration the DEPB and Duty Drawback Schemes, ultimately, it is observed and held in the case of **Liberty India (supra)** that DEPB / Duty Drawback Schemes are incentives which flow from the schemes framed by the Central Government or from Section 75 of the Customs Act, 1962 and, hence, incentive profits are not profits derived from the eligible business under Section 80-IB. It is observed that they belong to the category of ancillary profits of such undertakings.

7.4 Similar view was also expressed with respect to the Duty Drawback. Thereafter, in paragraph 43 of the above decision, it is observed and held that duty drawback, DEPB benefits, rebates, etc. cannot be credited against the cost of manufacture of goods debited in the profit and loss account for purposes of Sections 80-IA/80-IB as such remissions (credits) would constitute an independent source of income beyond the first degree nexus between profits and the industrial undertaking. Thus, it is observed and held that duty drawback receipts / DEPB benefits do

not form part of the net profits of eligible industrial undertakings for the purpose of Section 80-IB of the Act, 1961. The relevant discussions are in paragraphs 24, 28 to 36, 38, 39, 41, 43 and 45, which are as under:-

> **"24.** Before analysing Section 80-IB, as a prefatory note, it needs to be mentioned that the 1961 Act broadly provides for two types of tax incentives, namely, investment-linked incentives and profit-linked incentives. Chapter VI-A which provides for incentives in the form of tax deductions essentially belong to the category of "profit-linked incentives". Therefore, when Sections 80-IA/80-IB refers to profits derived from eligible business, it is not the ownership of that business which attracts the incentives. What attracts the incentives under Sections 80-IA/80-IB is the generation of profits (operational profits).
>
> XXXXXXXX
>
> **28.** In the present batch of cases, the controversy which arises for determination is: whether DEPB credit/duty drawback receipt comes within the first degree sources?
>
> **29.** According to the assessee(s), DEPB credit/duty drawback receipt reduces the value of purchases (cost neutralisation), hence, it comes within first degree source as it increases the net profit proportionately.
>
> **30.** On the other hand, according to the Department, DEPB credit/duty drawback

receipt do not come within the first degree source as the said incentives flow from the incentive schemes enacted by the Government of India or from Section 75 of the Customs Act, 1962. Hence, according to the Department, in the present cases, the first degree source is the incentive scheme/provisions of the Customs Act. In this connection, the Department places heavy reliance on the judgment of this Court in *Sterling Foods* [(1999) 4 SCC 98 : (1999) 237 ITR 579] .

31. Therefore, in the present cases, in which we are required to examine the eligible business of an industrial undertaking, we need to trace the source of the profits to manufacture. (See *CIT* v. *Kirloskar Oil Engines Ltd.* [(1986) 157 ITR 762 (Bom)])

32. Continuing our analysis of Sections 80-IA/80-IB it may be mentioned that sub-section (13) of Section 80-IB provides for applicability of the provisions of sub-section (5) and sub-sections (7) to (12) of Section 80-IA, so far as may be, applicable to the eligible business under Section 80-IB. Therefore, at the outset, we stated that one needs to read Sections 80-I, 80-IA and 80-IB as having a common scheme.

33. On perusal of sub-section (5) of Section 80-IA, it is noticed that it provides for the manner of computation of profits of an eligible business. Accordingly, such profits are to be computed as if such eligible business is

the only source of income of the assessee. Therefore, the devices adopted to reduce or inflate the profits of eligible business has got to be rejected in view of the overriding provisions of sub-section (5) of Section 80-IA, which are also required to be read into Section 80-IB. [See Section 80-IB(13)]. We may reiterate that Sections 80-I, 80-IA and 80-IB have a common scheme and if so read it is clear that the said sections provide for incentives in the form of deduction(s) which are linked to profits and not to investment.

34. On an analysis of Sections 80-IA and 80-IB it becomes clear that any industrial undertaking, which becomes eligible on satisfying sub-section (2), would be entitled to deduction under sub-section (1) only to the extent of profits derived from such industrial undertaking after specified date(s). Hence, apart from eligibility, sub-section (1) purports to restrict the quantum of deduction to a specified percentage of profits. This is the importance of the words “derived from industrial undertaking” as against “profits attributable to industrial undertaking”.

35. DEPB is an incentive. It is given under the Duty Exemption Remission Scheme. Essentially, it is an export incentive. No doubt, the object behind DEPB is to neutralise the incidence of customs duty payment on the import content of export product. This neutralisation is provided for by credit to customs duty against export product. Under DEPB, an exporter may apply for credit

as percentage of FOB value of exports made in freely convertible currency. Credit is available only against the export product and at rates specified by DGFT for import of raw materials, components, etc. DEPB credit under the Scheme has to be calculated by taking into account the deemed import content of the export product as per the basic customs duty and special additional duty payable on such deemed imports.

36. Therefore, in our view, DEPB/duty drawback are incentives which flow from the schemes framed by the Central Government or from Section 75 of the Customs Act, 1962, hence, incentives profits are not profits derived from the eligible business under Section 80-IB. They belong to the category of ancillary profits of such undertakings.

XXXXXXXX

38. Section 75 of the Customs Act, 1962 and Section 37 of the Central Excise Act, 1944 empower the Government of India to provide for repayment of customs and excise duty paid by an assessee. The refund is of the average amount of duty paid on materials of any particular class or description of goods used in the manufacture of export goods of specified class. The Rules do not envisage a refund of an amount arithmetically equal to customs duty or central excise duty actually paid by an individual importer-cum-manufacturer. Sub-section (2) of Section 75 of the Customs Act requires the amount of

drawback to be determined on a consideration of all the circumstances prevalent in a particular trade and also based on the facts situation relevant in respect of each of various classes of goods imported. Basically, the source of duty drawback receipt lies in Section 75 of the Customs Act and Section 37 of the Central Excise Act.

39. Analysing the concept of remission of duty drawback and DEPB, we are satisfied that the remission of duty is on account of the statutory/policy provisions in the Customs Act/Scheme(s) framed by the Government of India. In the circumstances, we hold that profits derived by way of such incentives do not fall within the expression "profits derived from industrial undertaking" in Section 80-IB.

XXXXXXXX

41. The cost of purchase includes duties and taxes (*other than those subsequently recoverable by the enterprise from taxing authorities*), freight inwards and other expenditure directly attributable to the acquisition. Hence trade discounts, rebate, duty drawback, and such similar items are *deducted* in determining *the costs of purchase. Therefore, duty drawback, rebate, etc. should not be treated as adjustment (credited) to cost of purchase* or manufacture of goods. They should be treated as separate items of revenue or income and accounted for accordingly (see p. 44 of *Indian Accounting Standards & GAAP* by Dolphy D'Souza).

XXXXXXXX

> **43.** Therefore, we are of the view that duty drawback, DEPB benefits, rebates, etc. cannot be credited against the cost of manufacture of goods debited in the profit and loss account for purposes of Sections 80-IA/80-IB as such remissions (credits) would constitute independent source of income beyond the first degree nexus between profits and the industrial undertaking.

XXXXXXXX

> **45.** In the circumstances, we hold that duty drawback receipt/DEPB benefits do not form part of the net profits of eligible industrial undertaking for the purposes of Sections 80-I/80-IA/80-IB of the 1961 Act. The appeals are, accordingly, dismissed with no order as to costs."

7.5 Prior thereto, the treatment of "profits and gains derived from industrial undertakings" for the purpose of determining tax liability came up for consideration before this Court in the case of **Sterling Foods, Mangalore (supra)**, which was followed by this Court in the case of **Liberty India (supra)**. In the case of **Sterling Foods, Mangalore (supra)**, in paragraph 7 and 13, it is observed and held as under:-

"7. The question, therefore, was whether the income derived by the assessee by the sale of the import entitlements was profit and gain derived from its industrial undertaking of processing seafood. The Division Bench of the High Court came to the conclusion that the income which the assessee had made by selling the import entitlements was not a profit and gain which it had derived from its industrial undertaking. For that purpose, it relied upon the decision of this Court in *Cambay Electric Supply Industrial Co. Ltd.* v. *CIT* [(1978) 2 SCC 644 : 1978 SCC (Tax) 119 : (1978) 113 ITR 84]. It was there held that the expression "attributable to" was wider in import than the expression "derived from". The expression of wider import, namely, "attributable to", was used when the legislature intended to cover receipts from sources other than the actual conduct of the business. The Division Bench of the High Court observed that to obtain the benefit of Section 80-HH the assessee had to establish that the profits and gains were derived from its industrial undertaking and it was just not sufficient that a commercial connection was established between the profits earned and the industrial undertaking. The industrial undertaking itself had to be the source of the profit. The business of the industrial undertaking had directly to yield that profit. The industrial undertaking had to be the

direct source of that profit and not the means to earn any other profit. Reference was also made to the meaning of the word “source”, and it was held that the import entitlements that the assessee had earned were awarded by the Central Government under the scheme to encourage exports. The source referable to the profits and gains arising out of the sale proceeds of the import entitlement was, therefore, the scheme of the Central Government and not the industrial undertaking of the assessee.

XXXXXXXX

13. We do not think that the source of the import entitlements can be said to be the industrial undertaking of the assessee. The source of the import entitlements can, in the circumstances, only be said to be the Export Promotion Scheme of the Central Government whereunder the export entitlements become available. There must be, for the application of the words “derived from”, a direct nexus between the profits and gains and the industrial undertaking. In the instant case the nexus is not direct but only incidental. The industrial undertaking exports processed seafood. By reason of such export, the Export Promotion Scheme applies. Thereunder, the assessee is entitled to import entitlements, which it can sell. The sale consideration therefrom cannot, in our view, be held to

> constitute a profit and gain derived from the assessee's industrial undertaking."

7.6 Therefore, following the law laid down by this Court in the case of **Sterling Foods, Mangalore (supra)** and **Liberty India (supra)** as such, no error has been committed by the High Court in holding that on the profit from DEPB and Duty Drawback claims, the assessee shall not be entitled to the deductions under Section 80-IB as such income cannot be said to be an income "derived from" industrial undertaking and even otherwise as per Section 28(iiid) and (iiie), such an income is chargeable to tax.

7.7 Insofar as reliance placed by the learned counsel for the assessee upon the subsequent decision of this Court in the case of **Meghalaya Steels Limited (supra)** is concerned, at the outset, it is required to be noted that in the case of **Meghalaya Steels Limited (supra)**, it was a case of three subsidies, namely a) Transport Subsidy, b) Interest Subsidy, and c) Power Subsidy and in that context this Court observed and held that since these subsidies directly affect the cost of manufacturing, they have a direct nexus with the profits and gains of the undertaking and since these subsidies have a direct

nexus, they can be said to be derived from the industrial undertaking. It is to be noted that in the case of **Meghalaya Steels Limited (supra)**, this Court did take note of the decision in the case of **Liberty India (supra)**, however, this Court specifically observed that the case of **Liberty India (supra)** was concerned with an export incentive, which is very far removed from reimbursement of an element of cost. While dealing with the decision in the case of **Liberty India (supra)**, this Court distinguished Duty Entitlement Pass Book and Duty Drawback Schemes and specifically observed that the DPEB / Duty Drawback Scheme is not related to the business of an industrial undertaking for manufacturing or selling its products and the DEPB entitlement arises only when the undertaking goes on to export the said product, that is, after it manufactures or produces the same. In paragraph 20, in the case of **Meghalaya Steels Limited (supra)**, while distinguishing the profit derived from DEPB / Duty Drawback, it is observed and held as under:-

> **"20.** *Liberty India* [*Liberty India* v. *CIT*, (2009) 9 SCC 328] being the fourth judgment in this line also does not help the Revenue. What this Court was concerned with was an export incentive, which is very far removed from reimbursement of an element of cost. A DEPB drawback scheme is not related to the business of an industrial undertaking for

> manufacturing or selling its products. DEPB entitlement arises only when the undertaking goes on to export the said product, that is, after it manufactures or produces the same. Pithily put, if there is no export, there is no DEPB entitlement, and therefore its relation to manufacture of a product and/or sale within India is not proximate or direct but is one step removed. Also, the object behind DEPB entitlement, as has been held by this Court, is to neutralise the incidence of customs duty payment on the import content of the export product which is provided for by credit to customs duty against the export product. In such a scenario, it cannot be said that such duty exemption scheme is derived from profits and gains made by the industrial undertaking or business itself."

Thus, from paragraph 20 of the said decision, it can be seen that this Court did not disapprove of the decision of this Court in the case of **Liberty India (supra).** Even in the case of **Meghalaya Steels Limited (supra)**, this Court did not consider the earlier decision in the case of **Sterling Foods, Mangalore (supra)**. Thus, the decision of this Court in the cases of **Liberty India (supra)** and **Sterling Foods, Mangalore (supra)**, which as such are on DEPB / Duty Drawback Schemes clinch the issue at hand. It cannot be said that the decision taken in the case of **Meghalaya Steels Limited (supra)** is contrary to the decisions in the case of **Sterling Foods, Mangalore**

(supra) and **Liberty India (supra).** On the contrary, the observations made in paragraph 20 can be said to be in favour of the Revenue and against the assessee.

8. In view of the above and for the reasons stated above, the High Court has rightly held that the respondent – assessee is not entitled to the deductions under Section 80-IB on the amount of DEPB as well as Duty Drawback Schemes. We hold that on the profit earned from DEPB / Duty Drawback Schemes, the assessee is not entitled to deduction under Section 80-IB of the Act, 1961. Any contrary decision of any High Court is held to be not good law.

Present appeal deserves to be dismissed and is accordingly dismissed. However, in the facts and circumstances of the case, there shall be no order as to costs.

……J.
[M.R. SHAH]

……J.
[B.V. NAGARATHNA]

NEW DELHI;
APRIL 10, 2023.