EXPORT BLUES

(Whether deduction U/S 80-HHC of the Income-Tax Act, 1961 is allowable in respect of export incentives)

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In the last quarter of the financial year 2000-01, a serious controversy arose in the Income-Tax Department and export circles of Mumbai. The controversy related to the issue whether deduction U/S 80-HHC of the Income-Tax Act, 1961 (the Act), is allowable in respect of export incentives viz. cash compensatory support (CCS), duty drawback (DDK) and profit on sale of import entitlement licences (I/L). The aforesaid controversy arose mainly in view of the judgement of the Madras Bench of the ITAT in the case of **Krislar Diesel Engines (P) Ltd. Vs. ACIT, 74 ITD p.414 (Mad.-T).** Following the aforesaid judgement of the ITAT, Madras Bench, the Assessing Officers (AOs) have disallowed the claim of the tax-payers U/S 80-HHC in respect of the aforesaid export incentives. On account of such action of the AOs, the exporters, their I.T. Advisors and the Chartered Accountants etc., were highly agitated. A number of representations were made to the Chief Commissioner of Income-Tax, the Central Board of Direct Taxes (CBDT), the Revenue Secretary and even the Finance Minister, with the request that the aforesaid controversy must be resolved at the earliest, because it was creating a lot of uncertainty in the minds of the exporters.

There are two parts of the aforesaid judgement of the ITAT, which may be summarised, as follows:

(i) Deduction U/S 80-HHC is not allowable in respect of the amount received as export subsidy, duty draw-back and premium on export licences.

(ii) In case of loss in export business, no deduction U/S 80-HHC is allowable.

The judgement of the ITAT does not appear to be correct on both the counts. The biggest lacuna in the aforesaid judgement of the ITAT is that the very relevant Circulars of the CBDT and decision of the Special Bench of the ITAT on the issue, have not been considered in the aforesaid judgement. Besides, there are a number of other judgements of the High Courts and the ITAT, relevant to the issue, which have also not been considered by the ITAT in the aforesaid judgement.

All the aforesaid judgements and the Circulars of the CBDT and other relevant aspects, which have a direct impact on the aforesaid judgement of the ITAT, are discussed, as follows:

1. **Circular No. 564, dated 5.7.1990, beneficial to the tax-payers, was binding on the Income-Tax authorities.**

   The aforesaid controversy could have been avoided, had the AOs looked into Circular No.564 dated 5.7.1990 issued by the CBDT. S.80-HHC was amended w.e.f. 1.4.1992. After the aforesaid amendment,

the CBDT issued the aforesaid Circular No.564. Paras (5), (7) & (8) of the aforesaid Circular are relevant to the present issue. For ready reference, the same are reproduced, as follows:

"(5.) The Finance Act, 1990, has amended section 28 by inserting therein, clauses (iiia), (iiib) and (iiic) with retrospective effect with a view to ensuring that cash compensatory support (CCS), duty drawback (DDK) and profit on sale of import entitlement licences (I/L) shall be taxable under the head 'Profits and gains of business or profession'. **In view of this amendment, it is clarified that the three export incentives shall have to be included in the profits of the business for computing the deduction under section 80-HHC.** (Emphasis supplied)

(7) 'Total turnover' was not defined earlier. There has been lack of uniformity amongst the assessing authorities and many assessing authorities are treating export incentives to be a part of the total turnover. The Finance Act, 1990, has, therefore, clarified the position by inserting a definition for the term 'total turnover' in the Explanation below section 80-HHC. According to this definition, 'total turnover' shall exclude cash compensatory support, duty drawback and profit on sale of import entitlement licences.

(8) To sum up, the deduction shall be allowed in the following manner:-

$$\text{Profit of the business (including export incentives)} \times \frac{\text{Export turnover (sale proceeds actually received in foreign exchange)}}{\text{Total turnover (excluding export incentives)}}$$

In addition, paras (6) & (7) of another Circular No. 571 dated 1.8.1990 are also relevant to the issue.

All the relevant issues have been considered in the aforesaid Circulars of the CBDT. Para (5) of the Circular No. 564, is particularly important in this respect. It is made very clear in this Circular that the aforesaid three export incentives shall have to be included in the profits of the business for computing the deduction U/S 80-HHC of the Act. It may also be pointed out here that the aforesaid Circular of the CBDT, which is beneficial to the tax-payer, is binding on the Income-Tax authorities.

2. Circular No. 564, dated 5.7.1990 is binding on the Income-Tax authorities.

As per para (5) of the Circular No. 564 of the CBDT, it may be seen that it grants certain benefits to the tax-payers. This part of the Circular is thus, beneficial to the tax-payers and therefore, the same is binding on the Income-Tax authorities. For this proposition, no case law is required. However, there are three very important judgements, which may be referred in this context. These judgements are, as follows:

(i) **UCO Bank Vs. CIT, 237 ITR p.889 (SC)**

It was held in this case that the CBDT U/S 119 of the Act has power, inter-alia, to tone down the rigour of the law and ensure a fair enforcement of its provisions, by **issuing Circulars** in exercise of its statutory powers U/S 119 of the Act, **which are binding on the authorities in the administration of the Act.**

(ii) **Paper Products Ltd. Vs. Commissioner of Central Excise, 247 ITR p.128 (SC)**

It was held in this case that **Circulars are binding on the Department** and the correctness thereof cannot be challenged by the Department even on the ground of their being inconsistent with statutory provision.

(iii)**CST Vs. Indra Industries, 248 ITR p.338 (SC)**

In this case, it was held that **Circulars** issued by the Commissioner of Sales Tax are not binding on the assessees or the courts, but they **are binding on the Department** and the Department is not entitled to argue against the interpretation in the Circular.

In the light of the aforesaid judgements of the Apex Court, it is absolutely clear that a Circular, which is beneficial to the tax-payer, is binding on the authorities concerned. For our purpose, the aforesaid Circular of the CBDT was binding on the AOs.

It may also be stated here that the aforesaid Circular No. 564 of the CBDT has also been referred by the Hyderabad Bench of the ITAT in the case of **VBC Industries Ltd. Vs. Dy.CIT, 118 CTR p.422 (Hyd.T).** Besides, the aforesaid Circulars have also been referred by the Special Bench of the ITAT, Delhi, in the case of **International Research Park Laboratories Ltd. Vs. ACIT, 212 ITR (AT) p.1 (Delhi-T, SB).**

3. Even on merits, the deduction U/S 80-HHC is allowable in respect of the aforesaid export incentives.

Even on merits, the deduction U/S 80-HHC is allowable in respect of the aforesaid export incentive; first on the basis of Accounting Standard – 2 (AS-2) and secondly, the judgement of the Madras High Court. The same are discussed, as follows:

(i) **As per Accounting Standard - 2**

The aforesaid export incentives are integral part of the export business. It is a well-known fact that every exporter takes into consideration the export incentives while quoting the rates for export in the fiercely competitive international market. Hardly any export would be possible without such incentives. Moreover, the export incentives basically compensate the excise duty already paid on inputs, which can be reduced from the cost of the inputs. This would be in accordance with the Accounting Standard-2 (AS-2), on valuation of Inventories, which defines the 'cost of purchase'. As per this definition, the 'cost of purchase' consists of the purchase price including duties and taxes, freight inwards and other expenditure directly attributable to acquisition **less** trade discounts, rebates, **duty drawbacks** and **subsidies** in the year in which they are accounted, whether immediate or deferred, in respect of such purchase. If the exporter reduces the cost of purchase by the amount of duty drawback and export subsidy, then they will not appear as separate receipts and in most of the cases, the exports will show profits. However, this being a cumbersome exercise, most of the exporters show the export incentive as separate item but it does not make them any the less trading receipts.

(ii) **CIT Vs. Wheel & Rim Co. of India Ltd., 107 ITR p.168 (Mad.)**

In this case, the assessee, a company carrying on business in the manufacture and sale of cycle rims, became entitled to a sum of Rs. 1,60,717 from the Engineering Export Promotion Council for compensating the loss it suffered by exporting goods abroad rather than selling the goods in this country itself and this sum was included in the receipts which were taken into account for arriving at its business income. Further, by reason of another scheme, the assessee was granted, on the basis of its export performance, import licence and by sale of import licence, the assessee made profit of Rs.4,83,856. The ITO held that the cash subsidy of Rs. 1,60,717 and the profits from the sale of import entitlements amounting to Rs. 4,83,856 did not constitute profits and gains derived by the assessee by export of goods for the purpose of claiming rebate under the said section.

It was held by the Hon. High Court that the two amounts would necessarily constitute business receipts referable to or derived from the export of cycle rims and hence the Tribunal was right in its conclusion that the assessee was entitled to the rebate U/S 2(5)(a) of the Finance Act, 1966 on the two amounts. The relevant part of the judgement on p.172 of the Report is reproduced, as follows:

"In the first place, as we pointed out already, the receipt by way of subsidy and the receipt by way of the profits due to the sale of import entitlement are directly referable to the export of the cycle rims made by the assessee and consequently they can be said to be profits and gains derived from the export of cycle rims even on the basis of any theory of proximity. Secondly, by virtue of the fact that the amount of profits and gains derived from the export have to be ascertained only in accordance with the provisions of the Income-tax Act, 1961, and not independent of it, in view of the provisions contained in section 2(5)(d) of the Finance Act, 1966, and rule 2(2) made by the Central Board of Direct Taxes pursuant to section 2(5)(d), these two receipts have to be treated as profits referable to or derived from the said export. Under these circumstances we answer the question referred to us in the affirmative and in favour of the assessee."

4. The reliance of the ITAT, Madras Bench, on the judgement of the Apex Court in CIT Vs. Sterling Foods, 237 ITR p.579 (SC), was misplaced.

The ITAT, Madras Bench, in the case of **Krislar Diesel Engines (P) Ltd. Vs. ACIT, 74 ITD p.414 (Mad.-T)** has placed reliance on the judgement of the Apex Court in the case of **CIT Vs. Sterling Foods, 237 ITR p.579 (SC).** The reliance of the ITAT on the aforesaid judgement of the Apex Court in respect of the interpretation of provisions of S.80-HHC, was totally misplaced, as the aforesaid judgement of the Apex Court was rendered in context of the provisions of S.80-HH of the Act. It may be pointed out here that there is a very material difference between the language used in S.80-HH and the language used in S.80-HHC of the Act. In the aforesaid case, the Supreme Court was considering deduction U/S 80-HH and not U/S 80-HHC. It was held in this case that the profits from the sale of import entitlements could not be considered as derived from the industrial undertaking. However, it does not say that it cannot be considered as derived from export business.

This position has been amply clarified in a number of judgements by the Bombay, AP and Kerala High Courts. The relevant judgements of these High Courts are discussed as follows:

(i) **CIT Vs. Shirke Construction Equipments Ltd., 246 ITR p.429 (Bom.)**

It was held in this case that Ss.80-HH, 80-P and 80-M of the Act start with the words, "where the gross total income of an assessee includes any income by way of …..…". On the other hand, these

words do not find place in S.80-HHC. The aforesaid pre-condition is not there in S.80-HHC(3). S.80-HHC is a complete code in itself. The object behind the different language of S.80-HHC appears to be to give maximum benefit to the exporters who earn foreign exchange for the country and to encourage exports.

(ii) **CIT Vs. Gogineni Tobacco Ltd., 238 ITR p.970 (AP)**

The Hon. High Court has held that Ss. 80-HH and 80-HHC are totally different in their operation, the reason being that the language used in S.80-HH and S.80-HHC is different. The relevant observations of the Hon. High Court are to be found on pp.973 and 974 of the Report. The same are reproduced, as follows:

"Section 80-HH as it stood during the relevant period reads as follows:
'80-HH. (1) Where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking, or the business of a hotel, 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 from such profits and gains of an amount equal to twenty per cent. thereof.'

The expression 'gross total income' is defined under section 80B. It says:

" 'gross total income' means the total income computed in accordance with the provisions of this Act, before making any deduction under this Chapter."

Therefore, the deductions permissible under section 80-HH are from the gross total income, which are to be arrived at by computing the total income in accordance with the provisions of the Act. In other words, income has to be computed in accordance with the other provisions of the Act and arrive at the gross total income and from that gross total income, the deductions permissible under section 80-HH are to be allowed.

Whereas, the language used in section 80-HHC is entirely different. It says:
'80-HHC. (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 …..' (rest of the section is not relevant).

Therefore, section 80-HHC says that in computing the total income of the assessee, deductions of the profits derived by the assessee are to be allowed in accordance with and subject to the provisions of this section. The expression used is 'this section' that means section 80-HHC. It does not say that the

deduction is to be allowed from the gross total income. **Therefore, the interpretation applicable to section 80-HH is not relevant to section 80-HHC."** (Emphasis supplied)

(iii)**CIT Vs. A.V. Thomas & Co. Ltd., 225 ITR p.29 (Ker.)**

In this case, the Hon. High Court has held that a reading of S.80-AB would show that computation of deduction was geared to the amount of income, but coming to the provisions containing S.80-HHC, quantification of the amount of deduction was geared to the export turnover and not to the income. The relevant observations of the Hon. High Court are to be found on p.36 of the Report. The same are reproduced, as follows:

"A mere reading of section 80-AB would show that computation of deduction is geared to the amount of income, but coming to the provisions contained under section 80-HHC quantification of the amount of deduction is geared to the export turnover and not to the income. The term 'export turnover' is defined as 'sale proceeds of any goods, etc., exported out of India'. Apparently section 80-HHC was introduced by the Finance Act, 1983 to encourage export. We are, therefore, in full agreement with the view taken by the Tribunal that the assessee is entitled to claim deduction under section 80-HHC even if it has suffered loss in its business of export of cardamom. The decision of the Karnataka High Court is of no help to the Revenue. It was a case where provisions contained under sections 80-AB, 80-J and 80-HH were considered. It was held that for the purposes of sections 80-J and 80-HH, profits and gains of new undertakings are not commercial profits but only such profits as are computed in the manner laid down under the Act in pursuance of section 80-AB, as if each undertaking was a separate assessee. **In section 80-HH the deduction has to be quantified with reference to profits and gains and in section 80-J with reference to the capital employed and not with reference to turnover as in the case of section 80-HHC.** Therefore, the above decision has no application to the present case." (Emphasis supplied)

Besides, deduction allowable U/S 80-HHC is not restricted by the provisions of S.80-AB.

The deduction allowable U/S 80-HHC is not restricted within the limit prescribed U/S 80-AB, as the provisions of S.80-AB would not be attracted to the provisions of S.80-HHC. This proposition is based on the judgements of the ITAT in the following cases:

(i) **ITO Vs. General Supplies Agency, 66 Taxman (Mag.) p.108 (Coch.-T)**
(ii) **Expo Machinery Ltd. Vs. IAC , 31 ITD p.41 (Delhi.-T)**

In the light of the aforesaid judgements of the High Courts of Bombay, AP and Kerala, and the ITAT, it is quite clear that the reliance placed by the ITAT – Madras Bench, in the case of **Krislar Diesel Engines (P) Ltd. Vs. ACIT, 74 ITD p.414 (Mad.-T)**, the judgement of the Apex Court in **CIT Vs. Sterling Foods, 237 ITR p.579 (SC),** while interpreting the provisions of S.80-HHC; was totally misplaced.

5. **Besides, the judgement in 74 ITD p.414 (Mad.-T) was for the AY 1986-87 and therefore, not applicable w.e.f. 1.4.1992.**

Besides, the judgement of ITAT, Madras Bench, in the case of **Krislar Diesel Engines (P) Ltd. Vs. ACIT, 74 ITD p.414 (Mad.-T)**, is not applicable after the insertion of proviso to S.80-HHC (3) w.e.f. 1.4.1992, because in the aforesaid case, the ITAT was dealing with AY 1986-87.

Therefore, the reliance placed by the AOs on the aforesaid decision of the Madras Bench for AY for and from 1992-93, was also totally misplaced.

6. **The other part of the judgement of the ITAT, Madras Bench regarding non-allowance of deduction U/S 80-HHC in case of loss, in export business, is also not correct.**

The Hon. ITAT has held that in case of loss in export business, the deduction U/S 80-HHC cannot be allowed. While delivering this part of the judgement, the Hon. ITAT has not taken into consideration, the judgement of Kerala High Court, the judgement of Special Bench of the ITAT and the judgements of various other Benches of the ITAT. These judgements are discussed as follows:

(i) **CIT Vs. A.V. Thomas & Co. Ltd., 225 ITR p.29 (Ker.)**

This judgement has already been referred to earlier and relevant part of the judgment of Hon. High Court on p.36 of the Report, have also been reproduced earlier. It has been held in this judgement that under the provisions of S.80-HHC, the quantification of the amount of deduction was geared to the export turnover and not to the income. The term 'export turnover' is defined as 'sale proceeds of any goods, etc., exported out of India'. S. 80-HHC was introduced by the Finance Act, 1983 to encourage export. **Therefore, the assessee was entitled to claim deduction U/S 80-HHC even if it has suffered loss in its business of export of cardamom.**

(ii) **International Research Park Laboratories Ltd. Vs. ACIT, 212 ITR (AT) p.1 (Del.-T, SB)**

It was held in this case that profit need not be earned in export business to claim deduction U/S 80-HHC.

This is the judgement of a Special Bench of the ITAT and the same was binding on the ITAT Bench, Madras.

(iii)**S.I Property Development (P.) Ltd. Vs. IAC, 40 ITD P.494 (Mad.-T)**

It was held in this case that deduction U/S 80-HHC is available even if there is no profit from export business.

(iv)**A.M. Moosa Vs. ACIT, 54 TTJ, p.193 (Coch.-T)**

It was held in this case that even if profit derived from export U/S 80-HHC(3) is a negative figure, such a negative figure should be ignored and positive figure computed under proviso to S.80-HHC(3) must be allowed as a deduction.

(v) **Shriram Pistons & Rings Ltd. Vs. ACIT, 81 Taxman (Mag.) p.164, (Del.-T)**

It was held in this case that deduction U/S 80-HHC is not to be restricted to profits from business of export as shown in the return of income but has to be allowed on profit from such business as computed by the AO under the head 'Profits and gains of business or profession'.

(vi)**Prestige Foods Ltd. Vs. Dy.CIT, 61 ITD p.390 (Ind.-T)**

It was held in this case that where assessee had incurred loss on export of trading goods and profit from export manufacturing unit, deduction U/S 80-HHC was available on net result of both the activities.

(vii) **Harisons Malayalam Ltd. Vs. Dy.CIT, 60 ITD p.306 (Coch.-T)**

It was held in this case that where besides doing other business, assessee exported tea and received sale proceeds in foreign exchange and net result from export business was loss while there was income from other activities, assessee would be eligible to proportionate deduction as per provisions of S.80-HHC, if other conditions were fulfilled and assessee could not be denied deduction altogether by invoking S.80-AB.

(viii)**V.B.C. Industries Ltd. Vs. Dy. CIT, 48 ITD p.292 (Hyd.-T)**

It was held in this case that even if ultimate result of export business carried on was loss, if assessee carries on other businesses and earns income, then, assessee, is entitled to deduction U/S 80-HHC.

7. CONCLUSION

In the light of the aforesaid discussion, it is quite clear that the AOs in Mumbai, were not justified in following the aforesaid judgement of the ITAT, Madras Bench, in the case of **Krislar Diesel Engines (P) Ltd. Vs. ACIT, 74 ITD p.414 (Mad.-T)**, while ignoring the relevant beneficial Circular of CBDT (which was binding on them), judgements of the various High Courts and the judgements of the various Benches of the ITAT.

As a result of the aforesaid discussion, it may be safely concluded –

(i) the deduction U/S 80-HHC is allowable in respect of the export incentives in the form of cash compensatory support , duty drawback and profit on sale of import entitlement licences; and

(ii) the deduction U/S 80-HHC is allowable even if there is loss in export business.

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