

\$~15

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Reserved on: 26.02.2015
Pronounced on: 13.03.2015

+ **ITA 386/2013**

CIT

.....Appellant

Through: Sh. Balbir Singh, Sr. Standing Counsel
and Sh. Abhishek Singh Baghel, Advocate.

Versus

KEI INDUSTRIES LTD.

.....Respondent

Through: Sh. Satyen Sethi and Sh. Arta Trana
Panda, Advocates.

CORAM:

HON'BLE MR. JUSTICE S. RAVINDRA BHAT

HON'BLE MR. JUSTICE R.K. GAUBA

MR. JUSTICE S. RAVINDRA BHAT

%

1. The question of law framed in this case is as follows:

“Whether the learned Income Tax Appellate Tribunal was correct in holding that the loss suffered by the Assessee in a unit entitled for exemption under Section 10B of the Income Tax Act, 1961, can be set off against income from any other unit not eligible for such exemption?”

2. The brief facts of this appeal under Section 260A of the Income Tax Act, 1961 (hereinafter “the Act”) are as follows. M/s. Kei Industries Ltd., (hereinafter the “Assessee”) is a Public Limited company, engaged in the business of manufacturing cables, wires and stainless steel wires selling them to public sector companies and Electricity Board. It filed its return of

income on 29.09.2008 declaring ₹1,49,18,516/- as income for the year under consideration. It was assessed under the provisions of Section 143(3) of the Act. The Assessing Officer (AO) during the assessment proceedings, noticed that:

(i) The Assessee had a hundred per-cent export oriented undertaking (100% EOU) at Plot No.A-280 to 283, RIICO Industrial Area, Chopanki, Distt. Alwar (Rajasthan); was registered as EOU in Noida Special Economic Zone and eligible for deduction under Section 10B of the Act. This was the first year of operation of this Unit.

(ii) However, there was a loss of ₹ 2,00,29,769/- from this unit which the assessee had set off against the income of the other units.

3. The assessee was asked to explain as to why the set-off of this loss should not be disallowed, as the income of this unit was exempt from tax. In response, the Assessee furnished its detailed submissions, which, however, were rejected by the AO who was of the opinion that as Section 10B was in Chapter-III of the Act, under the heading *“incomes which do not form part of total income”*, legislative intent was clear that such income was exempt. The AO also held that such being the case, losses of the unit, too could not be set off against income of any other unit(s). Consequently, the loss of ₹ 2,00,29,769/- from the Chopanki Unit was not allowed to be set off from the income of other units.

4. Aggrieved, the assessee preferred an appeal to the Commissioner of Income Tax (Appeals) (hereafter “CIT (A)”). The CIT(A) confirmed the AO’s position and findings holding that:

“4.5 Thus, it may be seen that the provisions of clause (ii) of sub-section (6) of Section 10B provide for carry forward and set off of losses pertaining to the 100% export oriented units eligible for deduction under the said section. Therefore, if what the Id. Counsel (for the Assessee) is arguing is to be accepted, then the provisions of section sub-clause(ii) of sub-section (6) shall become redundant. It has to be appreciated that when there is a specific provision for carrying forward and set off of losses sustained by the unit eligible for deduction under Section 10B, there is no occasion for the AO to take a liberal view and allow deduction of loss sustained by such unit against the income from other business not enjoying any tax benefits. There are decisions holding that the losses sustained by the eligible units are to be set off against the income of such eligible units in the subsequent years and thereafter, only to allow deduction of the balance profit.

5.6 In the case of CIT v. Himatasingike Side Ltd. 286 ITR 255, the Hon’ble Karnataka High Court has held that, “Section 10B cannot be read in isolation of other provisions. It is only an exemption provision. It may be true that even after taking into consideration the unabsorbed depreciation, the Assessee may get exemption but nonetheless it could not take only a portion of depreciation just to suit its income for the purposes of NIL liability and adjust the balance of unabsorbed depreciation against other business income once again to show NIL liability. The intention of the legislature was to provide 100% exemption only for export income and not for other income...Interpretation of a statute has to be meaningful and acceptable and it cannot be against the intentions of the legislation.

XXXXXX

XXXXXX

XXXXX

5.8 When the facts of the present case analysed in the light of the provisions of sub-section (3) to (6) of sub-section 10B, more particularly, clause (ii) of sub-section (6) and ratio laid down by the Hon’ble Karnataka High Court and ITAT, Chennai, the losses of eligible units are to be set off against the profits of such eligible units in the subsequent years.”

5. The ITAT, which the assessee approached, allowed the appeal. In doing so, it essentially relied on the ruling of a Division Bench of the Bombay High Court in *CIT vs. Galaxy Surfactants Ltd.* (343 ITR 102). The impugned order, *inter alia*, held that:

"11. We have heard both the sides in detail. We find that the decision of Hon'ble Bombay High Court in the case of CIT vs. Galaxy Surfactants Ltd. cited supra, is applicable to the facts of the assessee's case. In that case, the facts were as follows :-

"The assessee had a hundred per cent Export Oriented Unit (EOU) which was entitled to a deduction under section 10B. The previous year relevant to assessment year 2005-06 was the first year of production in the unit. During the year under consideration, the assessee disclosed a total profit of Rs. 16.82 crores from business. From this profit, a loss of Rs.5.56 crores sustained by the hundred per cent EOU was reduced. The loss in the EOU was principally on account of current depreciation which was set-off against the profits of the EOU. After reducing the loss sustained by the EOU against the profits of other units, the assessee disclosed a net taxable income of Rs.10.76 crores. The Assessing Officer held that a deduction under Section 10B had to be given in respect of the profits of the undertaking independently. The Assessing Officer held that a loss sustained by the eligible unit could not be set-off against the income of the other units. The Commissioner (Appeals) confirmed the order of the Assessing Officer. In appeal, the Tribunal, held that there was no justification in the action of the revenue in denying a set-off of a loss of the EOU against the profits of other units as claimed by the assessee."

On these facts, the Hon'ble Bombay High Court has decided the issue as under :-

"Section 70 provides for a setting off of a loss from one source falling under any head of income (other than capital gain) against income from any other source under the same head. Section 71 provides for the setting off of a loss with reference to one head of income against income from another head (save and except for capital gains). Under section 72, a provision has been made for carry forward and setting off of a loss sustained against the head of profits and gains of business or profession. Under section 72, where a loss which has been sustained under the head of profits and gains of business or profession cannot be set-off against income under any head of income under section 71 so much of the loss as has not been set-off or the entire loss where there is no income under any other head can be carried forward in the manner which is indicated in the provision. Section 72 which provides for a carry forward of a business loss comes into operation only when the provisions of sections 70 and 71, as the case may be, are exhausted. There is no provision in section 10B by which a prohibition has been introduced by the Legislature in setting off of a loss which is sustained from one source falling under the head of profits and gains of business against income from any other source under the same head. On the other hand, there is intrinsic material in section 10B to indicate that such a prohibition was not within the contemplation of the Legislature. Sub-section (7) of section 10B provides that the provisions of sub-section (8) and sub-section (10) of section 80-IA shall, so far as may be, apply in relation to the undertaking referred to in the section as they apply for the purposes of an undertaking referred to in section 80-IA. A similar provision corresponding to sub-section (5) of section 80-IA is to be found in sub-section (6) of section 80-I. Under sub-section (5) of section 80-IA which begins with overriding non obstante provisions, profits and gains of an eligible business to which sub-section (1) applies are for the purposes of determining the quantum of deduction to be computed as if such eligible business were the only source of income of the assessee during the previous year relevant to the

initial assessment year and to every subsequent assessment year. A provision akin to sub-section (5) of section 80-IA or for that matter akin to sub-section (6) of section 80-I has not been introduced by the Legislature when it enacted section 10B. The fact that unabsorbed depreciation can be carried forward to a subsequent year does not militate against the entitlement of the assessee to set-off a loss which is sustained by an eligible unit against the income arising from other units under the same head of profits and gains of business or profession. The Legislature not having introduced a statutory prohibition, there is no reason to deprive the assessee of the normal entitlement which would flow out of the provisions of section 70."

6. The revenue argues that the decision of the ITAT cannot be sustained. It was argued that *Galaxy Surfactants* (supra) noted the previous ruling of the same High Court in *Hindustan Lever Ltd. vs. Deputy Commissioner of Income Tax* (2010) 325 ITR 102 (Bom) and yet did not give much importance to the fact that unlike other provisions, Section 10B income was exempt and did not fall within the description of "income" which could be assessed or enter the field of taxation for the relevant year. It was submitted that *CIT v. Himatasingike Side Ltd.* 286 ITR 255, the Karnataka High Court decision stated the law correctly and was followed by the CIT (A). Learned counsel for the revenue argued that in the absence of a provision which enabled the inclusion of tax free income (under Section 10B) for purposes of computation, the assessee which derives income from such undertaking cannot set off such loss in respect of income liable for taxation. Learned counsel urged that this court should follow its previous Division Bench precedent in *CIT v. TEI Technologies (P) Ltd* (ITA No. 347/2011 & 2067/2010; decided on 27-08-2012; reported in [2014] 361 ITR 36).

7. Counsel for the assessee argued that the impugned judgment of the ITAT is sound and should not be upset. He relied on the decision of the Bombay High Court in *Galaxy Surfactants (supra)* and submitted that the previous ruling in *Hindustan Unilever Ltd. (supra)* also ruled that Section 10B is in the nature of deduction. Counsel highlighted that textually, Section 80A (4) of the Act affirms that provisions of Section 10A and 10B are in the nature of deductions. Section 80A(4) reads as follows:

“(4) Notwithstanding anything to the contrary contained in section 10A or section 10AA or section 10B or section 10BA or in any provisions of this Chapter under the heading “C – Deductions in respect of certain incomes”, where, in the case of an assessee, any amount of profits and gains of an undertaking or unit or enterprise or eligible business is claimed and allowed as a deduction under any of those provisions for any assessment year, deduction in respect of, and to the extent of, such profits and gains shall not be allowed under any other provisions of this Act for such assessment year and shall in no case exceed the profits and gains of such undertaking or unit or enterprise or eligible business, as the case may be.”

Counsel also submitted that another judgment of the Bombay High Court in *CIT v. Black and Veatch Consulting Pvt. Ltd.* (decided on 09.04.2012; [2012] 348 ITR 72 (Bom)) affirms that in fact Section 10B is in the nature of a deduction and not exemption. Consequently, losses of the tax-liable unit can be set off against the profits or income of the Section 10B unit. It was submitted that the Karnataka High Court decision in *Himatasingike Side Ltd (supra)* was rendered in the context of a claim for depreciation and not set off. Lastly, it was argued that it would be irrational to say that losses cannot be carried forward or set off against incomes which are not tax exempt,

because the facility of carry forward adjustment is available for a limited period.

Analysis and Conclusions

8. Section 2(45) of the Income-tax Act defines total income as “*the total amount of income referred to in section 5, computed in the manner laid down in this Act*”. Section 4 provides for charge of income-tax. Section 5 defines the scope of total income. Section 5 (1) states that subject to the provisions of the Act, the total income of any previous year of a person who is a resident includes all income from whatever source derived which— (a) is received or is deemed to be received in India in such year by or on behalf of such person; or (b) accrues or arises or is deemed to accrue or arise to him in India during such year; or (c) accrues or arises to him outside India during such year. Chapter III provides for incomes which do not form part of total income and Chapter IV deals with computation of total income. Sections 10A and 10B of the Act were inserted in 1981 and 1988 respectively; they continued with some amendments till 31.03.2001. Section 10A as enacted by Finance Act, 1981 read as under:

"10A. Special provision in respect of newly established industrial undertakings in the free trade zones.—(1) Subject to the provisions of this section, any profits and gains derived by an assessee from an industrial undertaking to which this section applies shall not be included in the total income of the assessee."

Likewise, Section 10B, inserted by the Finance Act, 1988 read as under:

"10B. Special provision in respect of newly established hundred per cent export oriented undertakings.—Subject to the provisions of this section, any profits and gains derived by an

assessee from a hundred per cent export oriented undertaking (hereafter in this section referred to as the undertaking) to which this section applies shall not be included in the total income of the assessee."

The Finance Act, 2000 substituted Sections 10A and 10B. Substituted Section 10A reads as follows:

"10A. (1) Subject to the provisions of this section, a deduction of such profits and gains as are derived by an undertaking from the export of articles or things or computer software for a period of ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce such articles or things or computer software, as the case may be, shall be allowed from the total income of the assessee...."

Substituted Section 10B (by Finance Act, 2000) reads as under:

"10B. (1) Subject to the provisions of this section, a deduction of such profits and gains as are derived by a hundred per cent export-oriented undertaking from the export of articles or things or computer software for a period of ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or things or computer software, as the case may be, shall be allowed from the total income of the assessee..."

9. What the assessee argued successfully in this case was that income from a Section 10B unit is in the nature of deduction, rather than exemption. If this contention is accepted, certain inevitable consequences would follow. Under the scheme of the Act, income computed under various heads - in accordance with provisions of Chapter IV of the Act has to be aggregated in terms of Chapter VI of the Act. Consequently, the first step would be that income/loss from various sources i.e. eligible and ineligible units, under the

same head are to be aggregated in terms of Section 70 of the Act. In the second step, income from one head is aggregated with the income or loss of the other head under Section 71 of the Act. In the third step, after giving effect to Sections 70 and 71 of the Act, if there is any income (where there is no brought forward loss to be set off in terms of Section 72 of the Act) and the same is eligible for *deduction* in terms of the Act, the same shall be allowed in computing the total income of the assessee. In the last step, if after aggregation of income in accordance with the provisions of sections 70 and 71 of the Act, there is a loss (in respect of assessment year 2001-02 and any subsequent year) from an eligible unit, it shall be eligible for carry forward and set off under Section 72 of the Act. Likewise, any loss from an ineligible unit can be carried forward and may be set off against the profits of eligible unit or ineligible unit as the case may be, in accordance with the provisions of Section 72.

10. In *Tei Technologies (supra)*, this Court noticed the legislative history of various provisions, including those relating to exemptions and, *inter alia*, Chapter III. The Court then took note of the retrospective amendment in 2003:

“13. The Finance Act, 2003 made significant changes both with prospective and retrospective effect from the assessment year 2001-2002. The significant retrospective amendment was the one which was made in sub-section (6) of Section 10A. This subsection contained provisions for ensuring that an assessee who enjoys the tax holiday under Section 10A does not enjoy any other tax concession. This aspect was earlier taken care of by sub-section (4), but when the entire Section was substituted and recast by the Finance Act, 2000 with effect from 1st April, 2001, sub-section (4) became subsection (6) but the essence and

substance of the provisions of these sub-sections remained the same. The effect was that from 1st April, 2001 (assessment year 2001- 2002) once the tax holiday ended, the bar or prohibition on enjoying other tax benefits such as carry forward and set off of laws (sic) and unabsorbed depreciation etc. came into force.

14. The rationale behind both sub-section (4) and sub-section (6) is not far to seek. The legislature obviously wanted to ensure that if the profits from the eligible undertaking are allowed to enjoy the benefits of Section 10A, they should not enjoy any further reliefs or benefits which are available under the provisions of the Act. We have already referred to this aspect when we referred to para 6.6 of the Circular No.308 dated 29.06.1981 (supra) which explained sub-section (4) of Section 10A when the section was introduced by the Finance Act, 1981. The same rationale holds good for sub-section (6) also. If the profits of the eligible undertaking do not enter the field of taxation for a particular period known as the tax holiday period, it stands to reason that when the profits enter the field of taxation after the period of the tax holiday, those profits should not be reduced or set off by other reliefs provided in the Act such as brought forward losses, brought forward unabsorbed depreciation, etc. The mandate of these sub-sections is that all such allowances and reliefs would be deemed to have been exhausted during the tax holiday period itself and no part thereof would survive for consideration after the tax holiday period. The amendment made by the Finance Act, 2003 to sub-section (6) with retrospective effect from 01.04.2001 made a significant departure from the legislative thinking outlined above. It provided that from the assessment year 2001-02, the right to carry forward the losses will be recognized. The result of this retrospective amendment is that even the bar on claiming the benefits of carried forward losses and allowances after the period of tax holiday is over was lifted and from the assessment year 2001-02, irrespective of the fact that the profits from the eligible unit do not enter the field of taxation, the assessee would be still entitled to claim those allowances and reliefs against the profits of the eligible undertaking. This has resulted in the position that a double benefit has been conferred on the eligible

profits from the assessment year 2001-02, which the section initially did not want to confer.”

Tei Technologies (supra) also noted that Section 10A, even after substantial amendment by the Finance Act, 2000, was retained in Chapter III of the Act, despite change in the language of sub-section (1). The court ruled that “*it was open to the legislature to transpose the section from Chapter III to Chapter VIA of the Act which is titled “deductions to be made in computing total income”*”. In this context, the Court approved the line of reasoning of the Karnataka High Court in *CIT v. Yokogawa India Ltd.*, (2012) 341 ITR 385 which held as follows:

“Parliament was aware of the various restricting and limiting provisions like section 80A and section 80AB which was in Chapter VI-A which do not appear in Chapter III. The fact that even after its recast, the relief has been retained in Chapter III indicates that the intention of Parliament it is to be regarded as an exemption and not a deduction. The Act of Parliament in consciously retaining this section in Chapter III indicates its intention that the nature of relief continues to be an exemption. Chapter VII deals with the incomes forming part of the total income on which no income-tax is payable. These are the incomes which are exempted from charge, but are included in the total income of the assessee. Parliament, despite being conversant with the implications of this Chapter, has consciously chosen to retain section 10A in Chapter III.”

11. The court then took note of various provisions which dealt with computation of total income, viz Section 2 (45); Section 14 and Section 80B (5) (“*gross total income*”) and held that:

“The position that emerges from a harmonious reading of these provisions is that the assessee is required to pay income tax on his total income of the previous year. The determination of the

total income is the last point before the tax is charged and once the total income is determined or quantified, there is absolutely no scope for making any further deduction, having regard to the provisions referred to above. If this is the true legal position, as we think it to be, then it is not possible to understand sub-section (1) of Section 10A as providing for a “deduction” of the profits of the eligible unit “from the total income of the assessee”. The definition of the expression total income given in Section 2(45) cannot be imported into the interpretation of sub-section (1) having regard to the context in which it is used and the scheme of the Act relating to the charge of the tax. It has to be kept in mind that the definition section would not apply if the context requires otherwise; in other words, if the scheme of the Act relating to the charge of income tax clearly makes it impossible for any deduction to be allowed once the total income is determined, then it would be futile to still insist on applying the definition of the expression “total income” under Section 2 (45) to the interpretation of the sub-section. In other words the context in which the expression “total income” is used in the sub-section requires us to abandon the definition of that expression as per Section 2 (45).”

Tei Technologies (supra) also noticed that though there was divergence of opinion between the Karnataka and Bombay High Courts as to whether Section 10A or Section 10B were in the nature of exempt income or deductions, there was agreement in both the opinions as to the manner of computation and that

“such profits have to be eliminated at the first stage itself, that is, as soon as they are computed, suggesting that it is an exemption provision. It was held that the eligible profits are not to be subjected to the adjustment under Section 72 of the Act, and the brought forward loss from the unit eligible for the relief under Section 10B cannot be adjusted against the profits from the other three eligible units, which in effect reiterates the position that the loss does not enter the field of taxation just as the profits also do not enter the field. This, with respect, lends support more to the

view that Section 10A and Section 10B are in the nature of exemption provisions, rather than provisions for deduction.”

12. At this stage, it would also be necessary to recollect the Supreme Court’s judgment in *Commissioner of Income-tax v. Williamson Financial Services and Ors.*, (2008) 297 ITR 17 (SC), which was taken note of in *Tei Technologies (supra)*. In *Williamson Financial Services (supra)*, the Supreme Court held that:

“At this stage we have to analyse Chapter III which deals with incomes which do not form part of total income. Section 10 groups in one place various incomes which are exempt from tax. The incomes enumerated in section 10 are not only excluded from the taxable income of the assessee but also from his total income. The exemption embodied in section 10 can be divided into two categories, namely, exemption to which certain classes of income from their very nature are entitled and the second category concerns exemption which the character of the assessee entitles him to claim. In the first category is agricultural income whereas in the second category of exempted income is the income of local authorities and diplomatic officers. We are concerned with the first category. In addition to the above two categories there is a third kind of income. These incomes are wholly or partly tax-free incomes on account of special deductions under Chapter VI-A. We are essentially concerned with these tax-free incomes.

XXXXXX

XXXXXX

XXXXXX

.... As stated above, there is a vital difference between income not chargeable to tax and not includible in the total income (for example, agricultural income) and income which forms part of total income but which is made tax-free. Deductions under Chapter VI-A fall in the category of tax-free incomes. In fact, history shows that some of the incomes in Chapter VI-A have been transferred from Chapter VII to Chapter VI-A. Chapter VII has been deleted. However, at the relevant time Chapter VII

referred to incomes forming part of total income on which no tax was payable. That is why we have stated that there is a difference between “exempted incomes” and “tax-free incomes”. This distinction is of some importance. As stated above, section 5 provides what the “total income” shall include. Chapter III refers to “incomes which do not form part of total income”. Chapter IV deals with “computation of total income”. It classifies the “income” under different heads and the deductions to be made in respect of each of the different heads of income. In the Income-tax Act, the expression “income includible in the total income” has a definite connotation. Similarly, the expression “deduction and allowances” have particular connotation. Therefore, on the one hand we have “agricultural income” which is neither chargeable nor includible in the total income and on the other hand we have “incomes” under Chapter VI-A which are part of total income but which are tax-free.”

13. This court in *Tei Technologies (supra)* also ruled out that by virtue of Section 80A (4) the position is any different. It was held that even if Section 10A/ Section 10B are treated as exemption provisions, Section 80A (4) cannot defeat that interpretation. The object of Section 80-A (4) was explained as ensuring that *“double benefit does not result to an assessee in respect of the same income, once under Section 10A or Section 10B or under any of the provisions of Chapter VIA and again under any other provision of the Act.”* It was held that even if Section 10A or Section 10B is construed as exemption provisions, *“it is still possible to invoke the sub-section and ensure that the assessee does not obtain a deduction in respect of the exempted income under any other provision of the Act. The only object of the sub-section is to ensure that there is no double benefit arising to the assessee in respect of the same income.”*

14. In this case, this court is of the opinion that *Tei Technologies (supra)* applies. The tax-exempt income of the assessee, eligible under Section 10-B could not have been set off against the losses from tax-liable income.

15. Accordingly, the question of law framed is answered in favor of the revenue and against the assessee. The appeal is, therefore, allowed.

S. RAVINDRA BHAT
(JUDGE)

R.K. GAUBA
(JUDGE)

MARCH 13, 2015

