

Pradnya Bhogale

**IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION
INCOME TAX APPEAL NO. 761 OF 2002**

M/s. Shivani Exports
a registered partnership
firm having its registered
office at 705, Magestic
Shopping Centre, 144 Girgaum,
Bombay-400 004.

..Appellant

vs.

1. Assistant Commissioner
of Income Tax Circle 19(1)
having office at Aayakar Bhavan,
Maharshi Karve Marg,
Bombay-400 020

2. Union of India,
through Ministry of Law,
Aayakar Bhavan, Maharshi Karve
Marg, Bombay-400 020

..Respondents

.....
Ms. A. Vissanji for Appellant.

Mr. A.R. Malhotra for Respondents.

.....
CORAM : NITIN JAMDAR &
M.S.KARNIK, JJ.

DATE : 8 JANUARY 2020

ORAL JUDGMENT (PER NITIN JAMDAR, J.) :-

The Appellant carried on business of exports of cut and polished diamonds. The Appellant, apart from the work of

cutting and polishing diamonds, also undertook work of other exporters on contract basis. By the Assessment Year 1991-92, period relevant for this appeal, the Appellant received an amount of Rs.22,48,436/- which was credited by the Appellant under the head "Factory labour charges". The Appellant also received an amount of Rs.73,078/- as "Labour charges commission" since the Appellant had given a work of cutting and polishing diamonds on sub-contracts.

2. The Appellant filed the return of income on 31 October, 1991 declaring income of Rs.2,23,810/- after claiming deduction of Rs.14,60,274/- under Section 80 HHC of the Income Tax Act, 1961. The Assessing Officer by order dated 18 March, 1993 excluded the amount of Factory Labour Charges and Labour Charges Commission totaling Rs.23,01,514/-. Having restricted the deduction under Section 80 HHC to Rs.11,18,588/-, the Assessing Officer passed the order on 18 March, 1993.

3. The Appellant filed an appeal with the Commissioner of Income Tax (Appeals), which was allowed in favour of the Appellant by order dated 25 October, 1994. The Respondent-Revenue filed I.T.A. No.293/B/1995 before the Income Tax Appellate Tribunal and the Tribunal allowed the Appeal of the Revenue by order dated 23 April, 2002. Hence, the present Appeal is filed by the Appellant-Assessee.

4. The Appeal was admitted on the following substantial question of law :-

“Whether on the facts and circumstances of the case the Respondent No.1 is justified in excluding from the total business income the labour charges amounting to Rs.22,28,436/- and Labour Commission of Rs.73,078/- for the purpose of calculating deductions under Section 80 HHC of the Act ?”

5. We have heard Ms. A. Vissanji for the Appellant and Mr. A.R. Malhotra for Respondents.

6. For the sake of convenience we have reproduced the impugned order which reads thus :

“Revenue is in appeal arising out of the order of CIT(A) dated 25.10.1994 and the only ground raised is as under.

“On the facts and in the circumstances in the case, the CIT(A) has erred in allowing the Assessee’s claim for deduction U/s 80 HHC on the Labour Charges and Labour Commission totaling to Rs.23,01,514/- received by them from local parties”.

2. As per A.O.’s Order U/s 143(3) dated 18.3.1993, the Labour Commission and Labour Charges received by the Assessee of Rs.23,01,514/- had no connection with the export business, therefore, while calculating deduction U/s 80 HHC, it was held that the assessee was not entitled for the said claim. The assessee has claimed the deduction U/s 80 HHC at Rs.14,18,224/- against which the Assessing Officer has allowed the deduction at Rs.11,18,580/-.

3. In first appeal, learned CIT(A) has referred a Board's circular No.564.571 and 621 and observed that as per section 80(II)C(3), the profit derived from export of goods or merchandise outside India is to be the amount which bears to the profits and gains of the business the same proportion as the export turnover bears to the total turnover of the business. Accordingly, she has held that the profit of a business have to be computed on the proportion of a business have to be computed on the proportion of the export turnover and total turnover with reference to that profit as would be computed under the head "Profit and Gains of Business or Profession". She has concluded that there was no jurisdiction for excluding such ancillary receipts and directed to allow deduction to the assessee.

4. On the date of hearing i.e. on 15.4.2002, an application for adjournment was moved from the side of the assessee, which was rejected on the ground that the only issue as per ground taken is covered by the decisions of jurisdictional high court, therefore, no point in keeping this appeal pending.

5. On behalf of Revenue Ld. DR Mr. Joe Sebastin appeared and cited two decisions of Bombay High Court in favour of Revenue, firstly, K.K. Doshi and Company 245 ITR 849 and secondly. S.G. Jhaveri Consultancy 248 ITR 854.

6. In view of the facts referred in above paras, we have found that the issue is directly covered in favour of Revenue by the decisions of jurisdictional High Court in the case of K.K. Doshi and Company (Supra) and S.G. Jhaveri Consultancy (Supra). Respectfully following the said decisions, we hereby reverse the finding of CIT(A) and allow the ground of 415the Revenue.

7. In the result, the appeal of the revenue is allowed."

7. The order passed by the Tribunal is based on the decisions rendered by this Court in the case of *K.K. Doshi and Co. v. Commissioner of Income-Tax*¹ and *S.G. Jhaveri Consultancy v. Commissioner of Income-Tax*². Thus that is the foundation of the order. The Assessment Year in question is of importance. The Assessment Year is 1991-92. The Section 80 HHC of the Act was amended with effect from 1 April 1992 and explanation was brought in the same. In the case of *K.K. Doshi and Co.* (supra), an issue arose whether the service charges constitute business income for the purposes of computing export profits under Section 80HHC. While deciding the question, the Division Bench made the following observations :-

“ The object of section 80HHC is to ascertain the export profits. It may be mentioned that in this case we are concerned with the law prior to the assessment year 1992-93. Under section 80HHC(3), as it stood before April 1, 1992, profits derived from exports were computed in the following manner :

$$\text{Business profits} \times \frac{\text{Export turnover}}{\text{Total turnover}}$$

The said formula, however, gave a distorted figure of export profits when receipts like interest, commission, etc., which do not have an element of turnover came to be included in the profit and loss account. Every assessee tries to inflate, in the above formula, the business profits and correspondingly, he tries to reduce the denominator, viz.,

1 245 ITR 849

2 248 ITR 854

total turnover. It is for this reason that the Legislature amended the above formula by amending the law from the assessment year 1992-93 by clarifying that in the above formula the business profits will not include receipts by way of brokerage, commission, interest, rent charges or any other receipt of a similar nature. However, as some expenditure might be incurred in earning the above income by way of brokerage, commission, etc., an ad hoc 10 percent deduction from such income was provided for to account for the expenses. Similarly, under Explanation (ba) to Section 80 HHC, the Legislature has explained that the words “total turnover” shall not include freight or insurance. On the other hand, vide clause (b) to the Explanation to section 80HHC, the Legislature has defined the words “export turnover” to mean the sale proceeds, but not freight or insurance. The combined meaning of clauses (b) and (ba) to the Explanation shows that the business profits in the above formula shall not include receipts by way of brokerage, commission, interest, rent charges or any other receipt of a similar nature as they do not have any nexus with the sale proceeds from export activities. Therefore, the service charges cannot be considered as part of the business profits while working out deductions under section 80HHC. The judgment of the Supreme Court in the case of CIT v. Sterling Foods (1999) 237 ITR 579, dealt with the provisions of section 80HH. In that judgment, the Supreme Court was required to construe the expression “derived from” in section 80HH. In that manner, the assessee was engaged in processing prawns. It earned import entitlements from the Central Government under an Export Promotion Scheme. The assessee was entitled to sell the same. The assessee sold the said entitlements. In its total income for the assessment year 1979-80, the assessee included the sale proceeds and claimed relief under section 80HH. The High Court held that the income which the assessee made by selling the

import entitlements was not a profit and gain which the assessee had derived from industrial undertaking. The Division Bench held in favour of the assessee on the basis of the retrospective amendment to section 28 of the Act by the Finance Act, 1990, making such receipts taxable as business profits. It was held by the Supreme Court that the word “derived” is followed by the word “from” which meant arising from a source. The Supreme Court held on the facts of that case that import entitlements did not originate from the industrial undertaking of the assessee, but it came from the Export Promotion Scheme of the Government. The Supreme Court held that the words “derived from” indicated a direct nexus between the profits and gains on the one hand and the industrial undertaking on the other hand since under section 80HH the expression used is “derived from the industrial undertaking”. In that matter, on the facts, the Supreme Court held that since the export entitlements were made available under the Scheme of the Government the nexus between the profits and the industrial undertaking was only incidental and not direct. Accordingly, the Supreme Court allowed the appeal of the Department. This judgment helps the case of the Department in this matter. Section 80HHC(1) clearly states that in computing the total income of the assessee, there shall be a deduction of the profits derived by the assessee from the export of goods. In other words, there should be a direct nexus between the profits on the one hand and the export activity on the other hand. Applying the ratio of the judgment of the Supreme Court to the facts of our case, the profits earned by the assessee on account of service charges cannot be said to have a direct nexus with the export activities of the assessee. Hence, to that extent, the assessee was not entitled to claim deduction under section 80HHC. ”

Thus, the Division Bench observing as above opined that though prior to the amendment export profits included interest, commission, etc., which did not have element of turnover came to be included in the profit and loss account. By way of amended provisions in the Explanation (ba) to Section 80HHC of the Income Tax Act, 1961 it was no longer permissible to do so. The Division Bench opined that there was no nexus between the profits on the one hand and the export activity on the other hand, which was necessary.

8. The question of retrospective operation of the 1991 amendment to Section 80HHC arose for consideration of the Supreme Court in the case of *P.R. Prabhakar v. Commissioner of Income-Tax*. The Supreme Court held that the amendment could not be considered as retrospective.

9. Thereafter when the challenge of the Respondent-Revenue to the decision of this Court in *K.K. Doshi and Co.* (supra) consideration of the Supreme Court. The Supreme Court disposed of the said appeal by observing thus :-

“The main point in this appeal is as to whether the amendment to section 80HHC of the Income-tax Act, 1961, brought about by the Finance (No.2) Act, 1991, with effect from April 1, 1992, is prospective in nature or is retrospective.

This court in the case of P.R. Prabhakar v. CIT [2006] 284 ITR 548, relying upon Circular No.621 dated December 19, 1991,

issued by the Central Board of Direct Taxes (CBDT), has held that the amendment in question is prospective in nature and the same is binding on the Revenue.

In view of Circular No.621 dated December 19, 1991 issued by the Central Board of Direct Taxes and the aforesaid judgment of this court, these appeals are accepted and the orders passed by the High Court of Bombay are set aside leaving the parties to bear their own costs.

The appeals stand allowed in the above terms.”

The Supreme Court thus noted the decision in the case of *P.R. Prabhakar (supra)* and disposed of the Appeal setting aside the order passed in *K.K. Doshi (supra)* holding that the amendment of 1 April, 1992 is prospective in nature.

10. In view of this dicta of the Supreme Court in the case of *P.R. Prabhakar (supra)* and *K.K. Doshi (supra)*, the foundation of the decision of the Tribunal does not survive and the question of law as framed will have to be answered against the Revenue.

11. In the circumstances, declaring thus, the Appeal is disposed of.

(M.S.KARNIK, J.)

(NITIN JAMDAR, J.)