

IN THE HIGH COURT OF JUDICATURE AT MADRAS

RESERVED ON : 18.02.2021

DELIVERED ON : 23.02.2021

CORAM:

THE HON'BLE MR. JUSTICE M.DURAIWAMY
AND
THE HON'BLE MRS.JUSTICE T.V.THAMILSELVI

T.C.A.Nos.817 & 818 of 2010

VTM Limited

(Formerly Virudhunagar Textile Mills Ltd.)

Sulakarai,

Virudhunagar - 626 003 ...Appellant/Respondent in both TCAs

v.

Dy. Commissioner of Income Tax.

Circle-1,

Virudhunagar ... Respondent in both TCAs

T.C.A.No.817 /2010 Appeal preferred under Section 260A of the Income Tax Act, 1961, against the order of the Income Tax Appellate Tribunal, Chennai, 'B' Bench, dated 19.06.2009 in ITA.No.2418/Mds/2006, preferred against order of the Commissioner of Income Tax(Appeals)-II, Madurai made in ITA.No.42/2006-07, dated 13.09.2006 against the Assessment order of the Assistant Commissioner of Income Tax, Circle -I, Virudhunagar, dated 23.03.2006, made in PAN./GIR.No.AAACV3775E for the assessment year 2002-03.

T.C.A.No.818 /2010 Appeal preferred under Section 260A of the Income Tax Act, 1961, against the order of the Income Tax Appellate Tribunal, Chennai, 'B' Bench, dated 19.06.2009 in ITA.No.2419/Mds/2006, preferred against order of the Commissioner of Income Tax(Appeals)-II, Madurai made in ITA.No.41/2006-07, dated 13.09.2006 against the Assessment order of the Assistant Commissioner of Income Tax, Circle -I, Virudhunagar, dated 23.03.2006, made in PAN./GIR.No.AAACV3775E for the assessment year 2003-04.

For Appellant : Mr. R. Srinivasan
(in both TCA)

For Respondent : Mr. M. Swaminathan
(in both TCA) Senior Standing Counsel
Asst. by Ms. V. Pushpa

COMMON JUDGMENT

M. DURAISWAMY, J.

T.C.A.No.817 of 2010 arises against the order passed in I.T.A.No.2418/Mds/2006 on the file of the Income Tax Appellate Tribunal, Chennai, 'B' Bench, for the Assessment Year 2002-03. T.C.A.No.818 of 2010 arises against the order passed in I.T.A.No.2419/Mds/2006 on the file of the Income Tax Appellate Tribunal, Chennai, 'B' Bench, for the Assessment Year 2003-04. Challenging the orders passed by the Tribunal, the assessee has filed the above appeals.

2. Since the issue involved in both the appeals are identical, both the appeals are disposed of by this common Judgment.

3. The appeals were admitted on the following substantial question of law:

" Whether the Appellate Tribunal was justified in reversing the order of the first appellate authority and restoring that of the Assessing Officer for excluding receipts arising in the core business and not specified in Explanation (baa) to Section 80 HCC ?"

4. The appellant company is engaged in the business of manufacture of cloth. For the assessment year 2002-03, the appellant filed its return of income on 28.10.2002 admitting total income of Rs.4,57,83,603/- after claiming deduction under section 80HHC to the extent of Rs.2,98,17,261/-. The return was processed under section 143(1). Subsequently, the appellant filed a revised return on 24.03.2004 admitting total income of Rs.3,44,96,795/- after claiming deduction under section 80HHC at Rs.4,11,04,069/-. The revised return was filed for the purpose of claiming higher deduction under section 80HHC on the ground that the export sales and domestic sales were to be considered separately as if there were separate books of account maintained by the appellant. In the mean time, the Assessing Officer reopened the assessment under section 148 on 17.1.2005, in response to which, the appellant filed its return of income admitting total income of Rs.4,57,83,063/- as per the original return filed. The Assessing Officer completed the reassessment proceedings by order dated 23.3.2006.

5. In respect of the assessment year 2003-04, the appellant filed its return of income on 29.11.2003 admitting total income of Rs.6,25,35,393/- after claiming deduction under section 80HHC to the extent of Rs.4,62,77,950/-. The return was processed under section 143(1) and subsequently, the case was

selected for scrutiny. The Assessing Officer completed the scrutiny assessment on 23.3.2006 determining the total income at Rs.8,90,29,588/- apart from long term capital loss at Rs.14,56,893/- to be carried forward.

6. The appellant is engaged in the business of manufacture of cloth at its factory at Sulakarai near Virudhunagar. In the said factory, the appellant manufactured cloth both for domestic sales and export sales. The major portion of the cloth manufactured was exported. The appellant claimed deduction under section 80HHC by computing profits for the export division separately and accordingly the entire profit relating to export sales was claimed as deduction under section 80HHC. The Assessing Officer found that the appellant had not maintained separate books of account for domestic sales and export sales but based on the combined books of account apportioned the purchase and sales and other expenditure for domestic and export sales. The Assessing Officer was of the view that in a case where no separate books of account maintained, deduction under section 80HHC is to be worked out based on the proportion of export turnover to total turnover as laid down in section 80HHC. In these circumstances, the Assessing Officer rejected the claim of the appellant-assessee. The assessee admitted before the Commissioner of Income Tax that no separate books of accounts were maintained for domestic sales and export sales. For computing the profits for export activities, the appellant allocated various expenditures on the basis of sales and production.

7. The appellant claimed deduction under section 80HHC based on separate accounts prepared from the same books of account after allocating the expenditure on the basis of production or on actual basis as submitted them. The Commissioner of Income Tax, in the appeal preferred by the assessee observed that only when separate books of accounts are maintained, the appellant would be entitled to claim deduction under section 80-HHC. In the absence of separate books of accounts, the Commissioner of Income Tax did not accept the contention of the appellant-assessee. The Assessing Officer included sales tax, sale of yarn (raw materials) and sale of condemned materials to the total turnover.

8. Relying upon the appellant's own case reported in 97 ITR 309, the Income Tax Appellate Tribunal, Madras Bench, held that if an assessee had generated profits on sale of raw materials and sale of condemned materials and if the said profits are included in the business income, then, these elements have to be included in the total turnover. The Commissioner of Income Tax directed the Assessing Officer to exclude sales tax from the total turnover following the decision

of this court reported in 272 ITR 652 (Commissioner of Income Tax v. Sundaram Fasteners). So far as the sale of yarn and sale of condemned materials are concerned, since there was element of profit, the inclusion of the same in the total turnover were confirmed by the Commissioner of Income Tax. So far as the insurance claim and the miscellaneous income are concerned, the Assessing Officer, reduced the amounts under the said heads from the profits of business to the extent of 90%. The Assessing Officer reduced these items on the ground that they were not derived from the business.

9. The appellant contended that the insurance claim received is not in the nature of rent, commission, brokerage, interest etc., and therefore, the Assessing Officer was not justified in reducing 90% of the same from the profits of business. Further, it is the contention of the appellant that the insurance claim was received during the course of business and therefore, the stand of the Assessing Officer that it is not attributable to business is not correct. Regarding the miscellaneous income, the assessee contended that it represents fine amount collected from employees towards fabric damage. Further it is contended that the appellant incurred expenditure by way of fabric damage on account of which the appellant received less sale consideration when the cloth was sold, which was partly compensated by the recoveries from the employees. Admittedly, the assessee's loss/damages was compensated by the insurance company. This compensation received from the insurance company cannot be termed as rent, commission, brokerage, interest, etc. Similarly, the fine amount collected from the employees towards fabric damage also cannot be reduced as it is only to compensate for less sale value. The appellant, while filing the return, offered the entire amount as business income and with reference to computation of deduction under section 80 HHC, the appellant treated the amount as receipts warranting 90% deduction under Clause (baa) to section 80HHC and increased the export profits with 90% of the said amounts in proportion to export turnover to total turnover as per the first proviso to(3).

10. For the purpose of computation of deduction under Clause (baa) to section 80HHC, it would be appropriate to extract Clause (baa) to section 80HHC, which reads as follows:-

[(baa) "profits of the business" means the profits of the business as computed under the head "Profits and gains of business or profession" as reduced by -

(1) ninety per cent of any sum referred to in Clauses (iiia), (iiib) [, (iiic), (iiid) and (iiie) of section 28 or of any receipts by way of brokerage,

commission, interest, rent, charges or any other receipt of a similar nature included in such profits; and

(2) the profits of any branch, office, warehouse or any other establishment of the assessee situate outside India;]

11. Mr. R. Srinivasan, learned counsel appearing for the appellant, in support of his contention, has relied upon the following judgments:-

(i) (2019) 103 Taxman.com 250 (SC) [Principal Commissioner of Income Tax v. Atul Ltd.], wherein the Hon'ble Supreme Court held as follows:-

" ... 4.1 Now so far the reliance placed upon the decision of the Hon'ble Supreme Court in the case of Ravindranathan Nair [(2007) 295 ITR 228/165 Taxman 285] is concerned on considering the facts of the case before the Hon'ble Supreme Court, we are of the opinion that the said decision would not be applicable to the facts of the case on hand. In the case before the Hon'ble Supreme Court the assessee claimed the deduction with respect to the charges paid for purchasing material of the purchasers. To that it was held that the same cannot be permitted to be deducted and the same cannot be said to be as income earned by business. As observed hereinabove, the issue is directly covered by the decision of the Division Bench of this Court in the case of Nirma Industries [(2006) 283 ITR 402 (Guj)]. We are in complete agreement with the view that the interest earned/charged by the assessee on the delayed payment of sale consideration (for 90 days) is not required to be excluded for the purpose of computation of deduction under Section 80HHC of the Act. No substantial question of law arises in the present Tax Appeal. Hence, the present Appeal deserves to be dismissed."

(ii) (2003) 127 Taxman 637 (Bombay) [Commissioner of Income Tax v. Bangalore Clothing Co], wherein the Division Bench of Bombay High Court held as follows:

"... 8. We do not find any merit in the argument advanced on behalf of the Department. In this case, we are concerned with profits from the business of exports of goods manufactured by the assessee. Therefore, the export profits were required to be computed in the ratio of export turnover to total turnover as contemplated by the above formula. Explanation (baa) was introduced into the Act by the

Finance (No. 2) Act, 1991, with effect from April 1, 1992. Under the Circular of the Central Board of Direct Taxes bearing No. 621, dated December 19, 1991 (see [1992] 195 ITR 154), it has been stated that the above formula gave a distorted figure of export profits when receipts like interest, commission, etc., which do not have an element of turnover are included by the assessee in the profit and loss account. Therefore, Explanation (baa) came to be introduced. Under that Explanation profits of the business, for the purposes of Section 80HHC, does not include receipts which do not have an element of turnover like rent, commission, interest, etc. However, as some expenditure might be incurred in earning such incomes an ad hoc 10 per cent. deduction from such incomes is provided to account for those expenses. However, learned counsel for the Department cannot invoke Explanation (ban) in every matter involving receipts by way of brokerage, commission, interest, rent, labour charges, etc. These items of income have got to be seen in the context of the business activity of the assessee. To give an example, in the case of a manufacturing company which undertakes exports, receipt of interest or commission may not be operational income because they do not have the element of turnover and consequently Explanation (baa) will apply. However, that will not be the case if the assessee is carrying on the business of financing because in the case of financing, the interest income which accrues to the assessee will have the element of turnover and in such a case, receipts like interest, will not attract Explanation (baa). The point which we would like to make, therefore, is that in every matter the Assessing Officer will have to ascertain whether receipt of interest, commission, labour charges, etc., were a part of operational income. We cannot lay down any standard test for deciding what would constitute operational income. Broadly, the Department will have to consider the memorandum and articles of association of the company, the nature of the business, the nature of the activity and such other tests. The Department will also have to ascertain as to what is the dominant business of the company and whether receipts like interest, commission, etc., accrue as a part of the main business activity or whether they accrue out of incidental business. In the case of CIT v. K. K. Doshi and Co. MANU/MH/0679/2000 : [2000]245ITR849(Bom) , the assessee had received Rs. 19.60 lakhs as service charges. It was held that the service charges of Rs. 19.60 lakhs did not have the element of turnover

because the charges were received for a seasonal activity which was not an integral part of the manufacturing activity. Therefore, the test to be applied in all such matters is, whether interest, service charges, commission accrue out of the main business activity of the company and whether they were operational income. The case of K. K. Doshi and Co. MANU/MH/0679/2000 : [2000]245ITR849(Bom) shows, that service charges of Rs. 19.60 lakhs did not represent operational income and, therefore, came within Explanation (baa). However, we find that the Department just looks at the nomenclature of the receipt and if it finds that the nomenclature is rent, interest, commission then without any further inquiry into the nature of business, the Department invokes Explanation (baa) which is not the purpose and the object of that Explanation. In the present case, the receipt in question is labour charges. However, this nomenclature may not be accurate. In the present case, the assessee is a manufacturer and exporter of garments. In the present case, the Tribunal has recorded a finding of fact which is not challenged, namely, that there was no difference between the activities relating to export business carried on by the assessee and the processes carried on for manufacturing garments for others under job work contracts. The Tribunal has further found, on the facts, that the activity of labour job involved use of machinery, labour and material which were also forming part of the activity of manufacturing garments for its own sales. The Tribunal further found that there was no difference between manufacturing of garments for the assessee's own sales and manufacturing of garments for others on labour job basis. These are findings of fact. They have not been challenged in the memo of appeal. The memo of appeal proceeds only on the basis that because the receipt is by way of labour charges, Explanation (baa) stood attracted. As stated above, each case will have to be examined by the Assessing Officer. As stated above, in each case of receipt of labour charges, rent, interest commission, etc., the Assessing Officer will have to ascertain whether the element of turnover existed. In the present case, the Tribunal has found, on the facts, that there was an element of job work turnover and, therefore, the Tribunal concluded on the facts of this case that the receipt of labour charges was not in the nature of brokerage, commission, rent, interest or charges as mentioned in Explanation (baa) to Section 80HHC. Further, the assessee received Rs. 66,35,083 as

processing charges. This can be seen from the profit and loss account. The company is engaged in manufacture and sale of garments, both domestically and by way of exports. The processing charges earned was by using the entire undertaking of the company which also manufactured garments for domestic sales and export sales and which processing charges were earned by incurring expenditure for the factory like wages, electricity charges, etc., debited in the profit and loss account. That, the income of Rs. 66,35,083 was only an income from business and the expenditure for earning this income is included in several items of expenditure debited in the profit and loss account. In these circumstances, we do not wish to interfere with the finding of fact recorded by the Tribunal. As stated above, if the receipt of labour charges (job work charges), interest, commission, etc., accrues by way of operating income then it falls outside Explanation (baa). In the present case, the receipt accrued from manufacturing activity, The Tribunal has found that job processing activity was linked to the manufacturing activity of the assessee. In the circumstances, on the facts, the judgments cited by the Department do not apply to this case. Lastly, we may point out that, in this case, there is no challenge to the findings of facts recorded by the Tribunal in relation to the processing activity forming part of the manufacturing activity of the assessee."

(iii) (2019) 419 ITR 123 (Mad) [JVS Exports v. Assistant Commissioner of Income Tax], wherein the Division Bench of this Court held as follows:

" ... 16. In Bangalore Clothing Co. [(2003) 260 ITR 371 (Bom.)], similar issue arose for consideration and the Court held that the Department cannot invoke Explanation (baa) in every matter involving receipts by way of brokerage, commission, interest, rent, labour charges, etc., and these items of income have to be seen in the context of the business activity of the assessee. It was pointed out that the Assessing Officer will have to ascertain whether the receipt of interest, commission, labour charges, etc., were a part of operational income. It was further pointed out that the Court cannot lay down any standard test for deciding what would constitute operational income and the Department will have to consider the memorandum of articles of association of company, the nature of the business, the nature of the activity and such other

tests. Further, the Department will also have to ascertain as to what is the dominant business of the company and whether receipts like interest, commission, etc., accrue as a part of the main business activity or whether they accrue out of incidental business. In the said case, the Tribunal, on facts, found that the job processing activity done by the assessee was linked to the manufacturing activity and affirmed the finding of the Tribunal holding that 90 per cent of labour charges ought not have been excluded from such business profits while computing deduction under Section 80HHC.

...

29. As mentioned earlier, the conversion of a portion of the sale proceeds as Fixed Deposits was done by the bank themselves and not on the volition of the assessee. Therefore, we are fully convinced that the transaction was connected and closely linked with the assessee's business activity. ..."

12.. Mr. M. Swaminathan, learned Senior Standing Counsel appearing for the respondent-Revenue submitted that the issue involved in the above appeals are covered by the decision of the Hon'ble Supreme Court reported in (2007) 295 ITR 0228 [Commissioner of Income Tax v. K. Ravindranathan Nair) wherein the Hon'ble Supreme Court held as follows:-

" ... 21. At the outset, we may state that, in the present case, we are dealing with the law as it stood during assessment year 1993-94. At that time Section 80HHC(3) of the I.T. Act constituted a Code by itself. Subsequent amendments have imposed restrictions/qualifications by which the said provision has ceased to be a code by itself. In the above formula there existed four variables, namely, business profits, export turnover, total turnover and 90% of the sums referred to in Clause (baa) to the said Explanation. In the computation of deduction under Section 80HHC all four variables had to be taken into account. All four variables were required to be given weightage. The substitution of Section 80HHC(3) secures profits derived from the exports of eligible goods. Therefore, if all the four variables are kept in mind, it becomes clear that every receipt is not income and every income would not necessarily include element of export turnover. This aspect needs to be kept in mind while interpreting Clause (baa) to the said Explanation. The said Clause stated that 90% of incentive profits or receipts by way of brokerage,

commission, interest, rent, charges or any other receipt of like nature included in Business Profits, had to be deducted from Business Profits computed in terms of Sections 28 to 44D of the I.T. Act. In other words, receipts constituting independent income having no nexus with exports were required to be reduced from Business Profits under Clause (baa). A bare reading of Clause (baa)(1) indicates that receipts by way of brokerage, commission, interest, rent, charges etc. formed part of gross total income being Business Profits. But for the purposes of working out the formula and in order to avoid distortion of arriving export profits Clause (baa) stood inserted to say that although incentive profits and "independent incomes" constituted part of gross total income, they had to be excluded from gross total income because such receipts had no nexus with the export turnover. Therefore, in the above formula, we have to read all the four variables. On reading all the variables it becomes clear that every receipt may not constitute sale proceeds from exports. That, every receipt is not income under the I.T. Act and every income may not be attributable to exports. This was the reason for this Court to hold that indirect taxes like excise duty which are recovered by the taxpayers for and on behalf of the government, shall not be included in the total turnover in the above formula (See: Commissioner of Income Tax, Coimbatore v. Lakshmi Machine Works MANU/SC/7335/2007 : [2007]290ITR667(SC)). . . ."

13. In the judgment reported in (2007) 295 ITR 0228 [cited supra) relied upon by learned Senior Standing Counsel appearing for the Revenue, the Apex Court clearly held that every receipt is not income and every income would not necessarily include element of export turnover. Further it has been held that this aspect needs to be kept in mind while interpreting Clause (baa) to the said Explanation. The said Clause stated that 90% of incentive profits or receipts by way of brokerage, commission, interest, rent, charges or any other receipt of like nature included in Business Profits, had to be deducted from business profits computed in terms of Sections 28 to 44D of the Income Tax Act. In other words, receipts constituting independent income had no nexus with exports were required to be reduced from business profits under Clause (baa). A bare reading of Clause (baa)(1) indicates that receipts by way of brokerage, commission, interest, rent, charges etc. formed part of gross total income being business profits. On a reading of all the variables, it becomes clear that every receipt may not constitute sale proceeds from exports and every receipt is

not income under the Income Tax Act and every income may not be attributable to exports.

14. In the case on hand, the insurance claim and miscellaneous income have no nexus with the assessee's business. Since there is no nexus, the Tribunal rightly reversed the order of the appellate authority restoring that of the Assessing Officer for excluding receipts arising in the core business and not specified in Explanation (baa) to Section 80 HCC. The insurance claim and miscellaneous income are not directly attributable to the business, hence, they are liable for 90% deduction.

15. The ratio laid down by the Hon'ble Supreme Court in the judgment reported in (2007) 295 ITR 0228 [supra] squarely applies to the facts and circumstances of the present case.

16. Though there is no dispute with regard to the ratio laid down in the judgments relied upon by the learned counsel for the appellant, since the facts and circumstances of the present cases are different, the same are not applicable.

17. Following the ratio laid down by the Hon'ble Supreme Court in the in the judgment reported in (2007) 295 ITR 0228 (supra), we do not find any ground much less any substantial question of law to interfere with the common order passed by the Income Tax Appellate Tribunal, 'B' Bench, Chennai, Hence, the Tax Case Appeals preferred by the appellant are liable to be dismissed. Accordingly, the Tax Case Appeals are dismissed. No costs.

Sd/-

Assistant Registrar (CS.II)

/True Copy/

Sub Assistant Registrar

To

1. The Deputy Commissioner of Income Tax, Circle-1, Virudhunagar
2. The Income Tax Appellate Tribunal, Chennai, 'B' Bench
3. The Commissioner of Income Tax (Appeals)-II, Madurai.
4. The Assistant Commissioner of Income Tax, Circle -I, Virudhunagar.

+1cc to Mr.M.Swaminathan, Advocate SR.NO..10837

AKM/17.03.21/ 11P-6C/

Judgment in
T.C.A.Nos.817 & 818 of 2010
23.02.2021