COMMISSIONER, INCOME TAX, THIRUVANANTHAPURAM

v.

K. RAVINDRANATHAN NAIR

NOVEMBER 13, 2007

[S.H. KAPADIA AND B. SUDERSHAN REDDY, JJ.]

Income Tax Act, 1961:

s.80HHC(3)(a), (b) and (c) and Clause (baa) to the Explanation to s.80HHC—Assessment Year 1993-94—Processing charges—Inclusion of, in the 'total turnover'—Held: Processing charges form part of gross total income hence includible in total turnover in the formula under s.80HHC.

s.80HHC(3)—Assessment Year 1993-94—Export of both self-manufactured goods and trading goods—Deduction under s.80HHC(3)(c)—Entitlement for—Held: Losses suffered by assessee in export of trading goods can be set off/adjusted against profits from export of manufactured goods and **vice versa**—*If after such adjustments, there is positive profits, assessee is entitled to deduction—If there is loss, he is not entitled to any deduction.*

The questions for consideration in these appeals are whether processing charges earned by assessee were includible in the "total turnover" in the formula in s.80HHC(3) of Income Tax Act, 1961 for the assessment year 1993-94, for computing deduction under s. 80HHC and whether in the computation of deduction, under s.80HHC(3)(c) losses suffered by the taxpayer in the export of trading goods can be set off/adjusted against profits from export of manufactured goods and *vice versa* and whether the assessee would be entitled to deduction if after such adjustments/set off the net figure is a loss.

Allowing the appeals filed by the Department except CA

A No.3167 of 2007 and remitting the matter to the A.O. for fresh disposal and dismissing CA No.3167 of 2007, the Court

HELD: 1. The formula in s.80HHC(3) of the Income Tax Act provided for a fraction of export turnover divided by total turnover to be applied to Business Profits calculated after deducting 90% of the sums mentioned in clause (baa) to the Explanation to s.80HHC. The profit incentives and items like rent, commission, brokerage, charges etc. though formed part of gross total income had to be excluded as they were "independent incomes" which had no element of export turnover. [Para 18] [1112-F-G]

1.2. Under s.80HHC(1) it is provided that in computing the "total income" a deduction of the profits derived by the assessee from the export of goods shall be made. The words "profits derived from exports" in the said sub-section was substituted for the words "whole of income" by Direct Tax Laws (Amendment) Act, 1989 w.e.f. 1.4.89. The expression "derived from" in the said sub-section is narrower than the expression "attributable to", therefore, it is only "profits derived from exports" which become the basis for working out the said formula in s.80HHC(3) of the Act.

[Para 17] [1111-E-G]

1.3. Before giving Deduction, under s.80HHC(3)(a), (b) or (c), the gross total income of the assessee being profits from business had to be arrived at in terms of clause (baa) to the said Explanation. While calculating "Business Profits" the same had to be done in terms of s. 28 to s.44D of the I.T. Act alone. Other provisions like ss. 70 and 71 of the I.T. Act were excluded. Therefore, if the said processing charges were part of gross total income of the taxpayer being profits from business then it had to be included in the total turnover in the above formula. The deduction has to be from profits as understood in the commercial sense. Moreover, under clause (baa)(1), 90% of any amount referred to in clause (iiia), (iiib) and (iiic) of s.28 of the I.T. Act or any receipts by way of brokerage, commission, interest, rent, charges or any other receipt of a similar nature included in such profits. The said expression "included in such

profits" indicated that the said processing charges formed part of the gross total income being business profits.

[Para 17] [1111-H; 1112-A-D]

1.4. The processing charges, which was part of gross total income, was an independent income like rent, commission, brokerage etc. and, therefore, 90% of the said sum had to be reduced from the gross total income to arrive at the Business Profits and since the said processing charge was an important component of Business Profits, it also had to be included in the total turnover in the said formula to arrive at business profits in terms of clause (baa) to the said Explanation. [Para 19] [1112-H; 1113-A]

2.1. During assessment year 1993-94, s.80HHC(3) 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 s.80HHC all four variables had to be taken into account. [Para 21] [1113-E-F]

2.2. If all the above 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 ss.28 to 44D of the I.T. Act. [Para 21] [1113-G-H; 1114-A]

Commissioner of Income Tax, Coimbatore **v.** *M/s. Lakshmi Machine Works,* **(2007) 6 Scale 168, relied on.**

3. The nature of every receipt needs to be ascertained in order to find out whether the said receipt forms part of/or that it has an attribute of an export turnover. When an indirect tax is collected by

A **the taxpayer on behalf of the Government the tax recovered is for the Government. It may be an income in the conceptual sense or even under the I.T. Act but while working out the formula under s.80HHC(3) and while applying the four variables one has to ascertain whether the receipt has an attribute of export turnover.**
B **An indirect tax like excise duty does not have that element of export turnover as understood in the above formula.**

[Para 23] [1114-G, H; 1115-A, B]

Commissioner of Income Tax, Coimbatore **v.** *M/s. Lakshmi Machine Works,* **(2007) 6 Scale 168, held inapplicable.**
C

4. A plain reading of s.80HHC makes it clear that in arriving at the profits earned from export of both self-manufactured goods and trading goods, the profits and losses in both the trades have to be taken into consideration. If after such adjustments there is a
D **positive profit, the assessee would be entitled to deduction under s.80HHC(1). If there is a loss he will not be entitled to any deduction.**

[Para 27] [1116-A, B]

A.M. Moosa **v.** *Commissioner of Income Tax,* **(200) 294 ITR 1**
E **SC, relied on.**

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 5173 of 2007.

From the final Judgment and Order dated 13.02.2003 of the High
F Court of Kerala at Ernakulam in ITA No. 105 of 2000.

WITH

C.A. Nos. 5174-5176, 5178, 5179 & 5181 of 2007, 3687 & 3167 of 2006.

G Vikas Singh, ASG., Dr. R.G. Padia & T.L.V. Iyer, Tufail A. Khan, Arijit Prasad, Rudreshwar Singh, B.V. Balaram Das, G. Prakash, Subramonium Prasad, Jay Kishor, E.M.S. Anam, Mukul Gupta, Mithilesh Singh, Ramesh Babu M.R., Sanjay Kunur and Ramesh N. Keshwani (for Keswani & Co.) for the Appearing parties.
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The Judgment of the Court was delivered by A

KAPADIA, J. *Processing*

Civil Appeal No. 5173 of 2007 arising out of S.L.P.(C) No.24617 of 2003,

Civil Appeal No. 5174 of 2007 arising out of S.L.P.(C) No.5647 of 2004, B

Civil Appeal No. 5175 of 2007 arising out of S.L.P.(C) No.6267 of 2004,

Civil Appeal No. 5181 of 2007 arising out of S.L.P.(C) No.12325 of 2004. C

Leave granted.

2. This is a batch of civil appeals filed by the Department. For the D sake of convenience we state the facts occurring in *Civil Appeal No. 5173 of 2007 arising out of S.L.P.(C) No.24617 of 2003 - Commissioner, Income Tax, Thiruvananthapuram* v. *K. Ravindranathan Nair.* Assessee-respondent has a factory in which he processes cashew nuts which are grown in his farm. Thereafter he exports E the cashew nuts as an exporter. For processing, the assessee has complete infrastructure. He has plant and machinery in his factory. At the same time, the assessee processes cashew nuts which are supplied to him by the exporters on job-work basis. After processing, the assessee returns the processed cashew nuts to the exporters. He earns processing charges. F Therefore, the assessee is an exporter and a job worker.

3. Computation of Export Incentive under Section 80HHC(3) of the Income Tax Act, 1961 ("I.T. Act", for short), is the issue for determination in this batch of civil appeals.

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4. The assessee made a claim for Export Incentive under Section 80HHC(3) in his returns filed for the assessment year 1993-94. The assessee did not include processing charges (receipts) in his total turnover. In his return, he indicated his business profits at Rs.1,94,08,220. The figure of Rs.1,94,08,220 included the processing charges (receipts) H

A amounting to Rs.1,54,68,811. However, the assessee did not include the processing charges amounting to Rs.1,54,68,811 in his total turnover. He contended that although the processing charges (receipts) amounting to Rs.1,54,68,811 constituted part of business profits as computed under Section 28 of the I.T. Act, since Section 80HHC (3) was the formula to B work out export incentive, the said figure of Rs.1,54,68,811 was not includible in the total turnover in the formula under the said Section 80HHC(3) of the I.T. Act. According to assessee, Section 80HHC(3) provided for computation of export incentive/concession to be computed by allocating business profits in the ratio of export turnover ÷ by total C turnover. This argument was not accepted by the Department.

5. The narrow dispute which arises for determination is: whether the Department was right in including processing charges, amounting to Rs.1,54,68,811, in the total turnover while arriving at export profits under Section 80HHC(3) of the Act, as it stood at the material time.

D

6. According to A.O., the gross total income of the assessee was Rs.1,94,08,220 from which an amount of Rs.1,74,13,200 (90%) was deducted in terms of clause (baa) to the Explanation to Section 80HHC to arrive at the Business Profits (See: page 52 of the S.L.P. paper book).

E

7. Shri T.L.V. Iyer, learned senior counsel appearing on behalf of respondent-assessee, submitted that Section 80HHC(3) of the I.T. Act provided for export incentives. According to learned counsel, the object behind enactment of the said sub-section was to encourage exports. He, therefore, submitted that the above formula should be read to exclude F processing charges from the total turnover in the above formula even though such charges constituted part of the business profits required to be calculated in terms of the provisions of Section 28 to 44D of the I.T. Act. According to learned counsel, the word "turnover" includes all receipts from sale of goods and not from sale of services. According to learned G counsel, the assessee had two independent businesses, in one case he processed and exported his own products and in the other he processed the raw material (cashew nuts) supplied by third parties which he processed for earning process charges. According to learned counsel, income from works contract by way of processing charges were not

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includible in the denominator, in the above formula, namely, total turnover. According to learned counsel, if processing charges were to be included in total turnover then the export incentives would stand reduced and that would defeat the very object behind enactment of Section 80HHC(3) of the I.T. Act. Further, according to learned counsel, Section 80HHC(3) had granted export incentives only in respect of receipts in foreign exchange from sale of goods and from processing provided such processing was done to goods which the taxpayer exported. That, he was not the exporter of goods which were only processed for third parties and, therefore, such processing charges were not includible in the total turnover even though, such charges were includible in the "business profits" under clause (baa) to the said Explanation. In this connection, learned counsel contended that such processing charges had no nexus with the activity of exports and, therefore, such charges were not includible in the total turnover. In this connection, reliance was placed on the judgment of this Court in the case of *Commissioner of Income Tax, Coimbatore* v. *M/s. Lakshmi Machine Works,* (2007) 6 Scale 168.

8. Mr. Vikas Singh, learned Addl. Solicitor General appearing on behalf of the Department, contended that in view of Explanation (ba) read with Explanation (baa) to Section 80HHC of the I.T. Act when the said processing charges were includible in the business profits the same were also simultaneously includible in total turnover in the above formula. According to learned counsel, Section 80HHC provided for export profits; that, in order to compute the quantum of eligible deduction under Section 80HHC of the I.T. Act, the Department was right in including the processing charges in the Business Profits and if such charges constituted part of Business Profits then such charges cannot be excluded from total turnover. That, Business Profits, under the above formula, was required to be calculated in accordance with clause (baa) to the said Explanation. According to learned counsel, keeping in mind the provisions of Explanation (ba) and Explanation (baa) it is clear that what was includible in the Business Profits in the above formula had to be included also in the total turnover. Therefore, according to learned counsel, the Tribunal as well as High Court had erred in holding that processing charges were not includible in the total turnover. In this connection, learned counsel

A placed heavy reliance on the judgment of the Rajasthan High Court in the case of *Commissioner of Income-Tax* v. *Sharda Gum and Chemicals,* (2007) 288 ITR 116 (Raj).

9. For the sake of convenience we quote hereinbelow Section 80HHC as it stood at the material time which reads as follow:

B

"Deduction in respect of profits retained for export business

80HHC. (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

C 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 :

D *Provided* that if the assessee, being a holder of an Export House Certificate or a Trading House Certificate (hereafter in this section referred to as an Export House or a Trading House, as the case may be,) issues a certificate referred to in clause (b) of sub-section (4A), that in respect of the amount of the export turnover specified

E therein, the deduction under this sub-section is to be allowed to a supporting manufacturer, then the amount of deduction in the case of the assessee shall be reduced by such amount which bears to the total profits derived by the assessee from the export of trading goods, the same proportion as the amount of export turnover

F specified in the said certificate bears to the total export turnover of the assessee in respect of such trading goods.

(1A) Where the assessee, being a supporting manufacturer, has during the previous year, sold goods or merchandise to any Export House or Trading House in respect of which the Export House

G or Trading House has issued a certificate under the proviso to sub-section (1), 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 sale of goods or merchandise to the Export House or

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Trading House in respect of which the certificate has been issued by the Export House or Trading House.

(2)(a) This section applies to all goods or merchandise, other than those specified in clause (b), if the sale proceeds of such goods or merchandise exported out of India are received in, or brought into, India by the assessee (other than the supporting manufacturer) in convertible foreign exchange , within a period of six months from the end of previous year or, where the Chief Commissioner or Commissioner is satisfied (for reasons to be recorded in writing) that the assessee is, for reasons beyond his control, unable to do so within the said period of six months, within such further period as the Chief Commissioner or Commissioner may allow in this behalf.

(b) This section does not apply to the following goods or merchandise, namely:--

(i) mineral oil; and

(ii) minerals and ores (other than processed minerals and ores specified in the Twelfth Schedule) .

Explanation 1.—The sale proceeds referred to in clause (a) shall be deemed to have been received in India where such sale process are credited to a separate account maintained for the purpose by the assessee with any bank outside India with the approval of the Reserve Bank of India.

Explanation 2.—For the removal of doubts, it is hereby declared that where any goods or merchandise are transferred by an assessee to a branch, office, warehouse or any other establishment of the assessee situate outside India and such goods or merchandise are sold from such branch, office, warehouse or establishment, then, such transfer shall be deemed to be export out of India of such goods and merchandise and the value of such goods or merchandise declared in the shipping bill or bill or export as I-ferred to in sub-section (1) of section 50 of the Customs Act, 1962 (52 of 1962), shall, for the purposes of this section, be

A deemed to be the sale proceeds thereof.

(3) For the purposes of sub-section (1),--

(a) where the export out of India is of goods or merchandise manufactured or processed by the assessee, the profits derived
B from such export shall be the amount which bears to the profits of the business, the same proportion as the export turnover in respect of such goods bears to the total turnover of the business carried on by the assessee;

C (b) where the export out of India is of trading goods, the profits derived from such export shall be the export turnover in respect of such trading goods as reduced by the direct costs and indirect costs attributable to such export ;

I where the export out of India is of goods or merchandise
D manufactured or processed by the assessee and of trading goods, the profits, derived from such export shall,--

(i) in respect of the goods or merchandise manufactured or processed by the assessee, be the amount which bears to the
E adjusted profits of the business, the same proportion as the adjusted export turnover in respect of such goods bears to the adjusted total turnover of the business carried on by the assessee; and

(ii) in respect of trading goods, be the export turnover in respect of such trading goods as reduced by the direct and indirect costs
F attributable to export of such trading goods :

Provided that the profits computed under clause (a) or clause (b) or clause (c) of this sub-section shall be further increased by the amount which bears to ninety per cent of any sum referred to in
G clause (iiia) (not being profits on sale of a licence acquired from any other person), and clause (iiib) and (iiic) of section 28, the same proportion as the export turnover bears to the total turnover of the business carried on by the assessee.

Explanations. — For the purposes of this sub-section,--

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(a) 'adjusted export turnover' means the export turnover as reduced by the export turnover in respect of trading goods;

(b) 'adjusted profits of the business' means the profits of the business as reduced by the profits derived from the business of export out of India of trading goods as computed in the manner provided in clause (b) of sub-section (3);

I 'adjusted total turnover' means the total turnover of the business as reduced by the export turnover in respect of trading goods;

(d) 'direct costs' means costs directly attributable to the trading goods exported out of India including the purchase price of such goods;

(e) 'indirect costs' means costs, not being direct costs, allocated in the ratio of the export turnover in respect of trading goods to the total turnover;

(f) 'trading goods' means goods which are not manufactured or processed by the assessee.

(3A) For the purposes of sub-section (1A), profits derived by a supporting manufacturer from the sale of goods or merchandise shall be,--

(a) in a case where the business carried on by the supporting manufacturer consists exclusively of sale of goods or merchandise to one or more Export Houses or Trading Houses, the profits of the business [***];

(b) in a case where the business carried on by the supporting manufacturer does not consist exclusively of sale of goods or merchandise to one or more Export Houses or Trading Houses, the amount which bears to the profits of the business [***] the same proportion as the turnover in respect of sale to the respective Export House or Trading House bears to the total turnover of the business carried on by the assessee.

(4) The deduction under sub-section (1) shall not be admissible

A unless the assessee furnishes in the prescribed form, along with the return of income, the report of an accountant, as defined in the *Explanation* below sub-section (2) of section 288, certifying that the deduction has been correctly claimed in accordance with the provisions of this section.

B

(4A) The deduction under sub-section (1A) shall not be admissible unless the supporting manufacturer furnishes in the prescribed form along with his return of income,--

(a) the report of an accountant, as defined in the *Explanation* C below sub-section (2) of section 288, certifying that the deduction has been correctly claimed on the basis of the profits or the supporting manufacturer in respect of his sale of goods or merchandise to the Export House or Trading House; and

D (b) a certificate from the Export House or Trading House containing such particulars as may be prescribed and verified in the manner prescribed that in respect of the export turnover mentioned in the certificate, the Export House or Trading House has not claimed the deduction under this section :

E *Provided* that the certificate specified in clause (b) shall be duly certified by the auditor auditing the accounts of the Export House or Trading House under the provisions of this Act or under any other law.

F *Explanation.*—For the purposes of this section,--

(a) 'convertible foreign exchange' means foreign exchange which is for the time being treated by the Reserve Bank of India as convertible foreign exchange for the purposes of the Foreign Exchange Regulation Act, 1973 (46 of 1973), and any rules made G thereunder;

(aa) 'export out of India' shall not include any transaction by way of sale or otherwise, in a shop, emporium or any other establishment situate in India, not involving clearance at any H customs station as defined in the Customs Act, 1962 (52 of 1962);

(b) 'export turnover' means the sale proceeds, received in, or brought into, India by the assessee in convertible foreign exchange in accordance with clause (a) of sub-section (2) of any goods or merchandise to which this section applies and which are exported out of India, but does not include freight or insurance attributable to the transport of the goods or merchandise beyond the customs station as defined in the Customs Act, 1962 (52 of 1962);

(ba) 'total turnover' shall not include freight or insurance attributable to the transport of the goods or merchandise beyond the customs station as defined in the Customs Act, 1962 (52 of 1962) :

Provided that in relation to any assessment year commencing on or after the 1st day of April, 1991, the expression total turnover shall have effect as if it also excluded any sum referred to in clauses (iiia), (iiib) and (iiic) of section 28;

(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) and (iiic) 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;

[***]

[***]

I 'Export House Certificate' or 'Trading House Certificate' means a valid Export House Certificate or Trading House Certificate, as the case may be, issued by the Chief Controller of Imports and Exports Government of India;

(d) 'supporting manufacturer' means a person being an Indian

A company or a person (other than a company) resident in India, manufacturing (including processing) goods or merchandise and selling such goods or merchandise to an Export House or a Trading House for the purposes of export."

B 10. Section 80HHC has been the subject-matter of frequent amendments. The said section was inserted in 1983. It was substituted in 1985. Thereafter, it was amended in 1986, 1988, 1989, 1990, 1991, 1992, 1994, 1999, 2000, 2003 and 2005. Therefore, while considering the applicability of Section 80 HHC, it is very important to keep in mind C the working of the said section as applicable in a given assessment year.

11. In this civil appeal we are concerned with the assessment year 1993-94.

12. At this stage, we may mention that, according to High Court, in D order to include any amount in the total turnover the said amount must either be the purchase price or the sale price or an item incidental to the transfer of the goods dealt with by the assessee. According to High Court, the assessee had processed raw cashew nuts belonging to third parties in his factory for which he received the said charges; that, the purpose behind E the said formula was to find out the profits attributable to export turnover i.e. profit on export sales. Further, according to High Court, in the above formula business income was to be computed in order to determine the quantum of eligible deduction. That, in the said formula, business income in the context of total turnover was income generated on purchase and F sales. That, in the context of Section 80HHC the total turnover referred to sales and purchase turnover and it did not include receipts in the nature of income which income was not attributable to sales. Further, according to High Court, even under the Circulars (Circular No.621 dated 19.12.91) issued by CBDT a clarification was issued to the effect that to G arrive at the quantum of eligible deduction under Section 80HHC, in the case of an assessee having export and domestic business, a fraction of export turnover to total turnover had to be applied to Business Profits computed under Section 28 of the I.T. Act. According to High Court, such processing charges with which we are concerned had no connection with the word "sale", therefore, they were not liable to be included in the H

total turnover.

13. Being aggrieved by the impugned judgments holding that the said charges were not includible in the total turnover, the Department has come to this Court by way of civil appeals.

14. This batch of civil appeals pertains to assessment year 1993-94, therefore, we have quoted the said section at it stood on the material date.

15. Section 80 HHC of the I.T. Act was not a charging section. It was an incentive provision. Its object was not to ascertain real income. Section 80HHC(3) provided for the following formula:

$$\text{Profits of the business} \times \frac{\text{export turnover}}{\text{total turnover}}$$

16. Section 80HHC had a Head Note. That Head Note said "*deduction in respect profits retained for export business*". The said Head Note was inserted by Finance Act, 1985 w.e.f. 1.4.86. Under the original section as inserted by Finance Act, 1983, the Head Note stated "*deduction in respect of export turnover*". Therefore, the very basis shifted from "export turnover" to "retention of profits for export business".

17. Under Section 80HHC(1) of the I.T. Act it was *inter alia* provided that in computing the "total income" a deduction of the *profits derived* by the assessee from the export of *goods* shall be made. That, that the words "profits derived from exports" in the said sub-section was substituted for the words "whole of income" by Direct Tax Laws (Amendment) Act, 1989 w.e.f. 1.4.89. The expression "derived from" in the said sub-section is narrower than the expression "attributable to", therefore, it is only "profits derived from exports" which become the basis for working out the said formula in Section 80HHC(3) of the Act. Similarly, by Finance Act, 1991 w.e.f. 1.4.92, for the first time, the expression "profits of the business" stood defined to mean the "*profits* of *the business*" as computed under the head "profits and gains of business", under Sections 28 to 44D of the I.T. Act. Therefore, before giving Deduction, under Section 80HHC(3)(a), (b) or (c) of the I.T. Act, the gross total income of the assessee being profits from business had to

A be arrived at in terms of clause (baa) to the said Explanation. However, one point needs to be noted, namely, while calculating "Business Profits" the same had to be done in terms of Section 28 to Section 44D of the I.T. Act alone. Other provisions like Sections 70 and 71 of the I.T. Act were excluded. Therefore, in our view, if the said processing charges were B a part of gross total income of the taxpayer being profits from business then it had to be included in the total turnover in the above formula. It is important that deduction has to be from profits as understood in the commercial sense. Moreover, under clause (baa)(1), 90% of any amount referred to in clause (iiia), (iiib) and (iiic) of Section 28 of the I.T. Act or C any receipts by way of brokerage, commission, interest, rent, charges or any other receipt of a similar nature *included in such profits*. The said expression "included in such profits" indicated that the said processing charges formed part of the gross total income being business profits. This has been clarified by clause (baa) to the said Explanation which inserted D the definition of "profits from business" in the said Section 80HHC(3) of the I.T. Act.

18. In the present case the A.O. had worked out Business Profits of Rs.1,94,08,220 as gross total income on the basis of income received from cashew business (See: pages 50 and 52 of the SLP Paper book). E Even according to assessees, in the above formula his Business Profits included the above-mentioned processing charges. However, according to assessees, the said charges were not to be included in the total turnover. We are not inclined to accept the contention of the assessees. The above discussion indicates that the formula in Section 80HHC(3) of F the I.T. Act provided for a fraction of export turnover divided by total turnover to be applied to Business Profits calculated after deducting 90% of the sums mentioned in clause (baa) to the said Explanation. That, profit incentives and items like rent, commission, brokerage, charges etc. though formed part of gross total income had to be excluded as they were G "*independent incomes*" which had no element of export turnover. That, the said items distorted the figure of export profits.

19. In our view, for the above reasons, the said processing charges, which was part of gross total income, was an independent income like H rent, commission, brokerage etc. and, therefore, 90% of the said sum had

to be reduced from the gross total income to arrive at the Business Profits and since the said processing charge was an important component of Business Profits, it also had to be included in the total turnover in the said formula to arrive at business profits in terms of clause (baa) to the said Explanation. A

20. One point still remains for consideration. On behalf of assessees it has been vehemently urged that the above-mentioned processing charges, earned by the assessees by processing raw cashew nuts for third parties, had no nexus with the export business and, therefore, such charges were not includible in the total turnover. It was also further argued that export incentives were admissible only in respect of profits on export sales. In this connection, it was submitted that the assessees earned processing charges from an activity which had no connection with exports. According to assessees, no export turnover arose from processing of raw material by the assessees for third parties and, therefore, the said receipts did not constitute an element of total turnover. Therefore, according to assessees, the A.O. had erred in including the said charges in the total turnover. According to assessees, profits derived from local sales were includible in Business Profits but not in the total turnover. B C D

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 E F G H

A 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

B 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

C 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

D 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. *M/s. Lakshmi Machine Works,* (2007) 6 Scale

E 168).

22. In the present case, the processing charges were included in the gross total income from cashew business. That, even according to assessee the said charges constituted an important component of gross total income from cashew business. This is not disputed. Therefore, in terms of clause

F (baa), 90% of the "independent income" had to be deducted from gross total income to arrive at Business Profits to which the fraction had to be applied. Since, the processing charges constituted independent income similar to rent, commission, etc., which formed part of the gross total income, the same had to be reduced by 90% as contemplated in clause

G (baa) to arrive at Business Profits. Therefore, the said processing charges were includible in the total turnover in the formula under Section 80HHC(3) of the I.T. Act.

23. Before concluding we state that the nature of every receipt needs

H to be ascertained in order to find out whether the said receipt forms part

of/or that it has an attribute of an export turnover. When an indirect tax is collected by the taxpayer on behalf of the government the tax recovered is for the government. It may be an income in the conceptual sense or even under the I.T. Act but while working out the formula under Section 80HHC(3) of the I.T. Act and while applying the four variables one has to ascertain whether the receipt has an attribute of export turnover. An indirect tax like excise duty does not have that element of export turnover as understood in the above formula. As stated above, it is recovered by the taxpayer on behalf of the government. Therefore, in the present cases, our judgment in *Commissioner of Income Tax, Coimbatore v. M/s. Lakshmi Machine Works*, (2007) 6 Scale 168, has no application.

24. Accordingly, the impugned judgments of the High Court and the Tribunal are set aside and the above civil appeals filed by the Department are accordingly allowed with no order as to costs.

Loss (Negative Profits)

Civil Appeal No. 5178 of 2007 arising out of S.L.P.(C) No.13747 of 2004,

Civil Appeal No. 5179 of 2007 arising out of S.L.P.(C) No.13748 of 2004,

Civil Appeal No. 3687 of 2005.

25. Leave granted.

26. A short question which arises for determination in this batch of civil appeals filed by the Department is:

> "Whether in the matter of computation of deduction, under Section 80HHC(3)(c) of the I.T. Act, losses suffered by the taxpayer in the export of trading goods can be set off/adjusted against profits from export of manufactured goods and *vice versa* and whether the assessee would be entitled to deduction if after such adjustments/set off the net figure is a loss."

27. In a recent judgment of this Court in the case of *A.M. Moosa v. Commissioner of Income-tax*, [2007] 294 ITR 1 SC, this Court vide

A para 11 has ruled as follows:

> "A plain reading of section 80HHC makes it clear that in arriving at the profits earned from export of both self-manufactured goods and trading goods, the profits and losses in both the trades have to be taken into consideration. If after such adjustments there is a positive profit, the assessee would be entitled to deduction under section 80HHC(1). If there is a loss he will not be entitled to any deduction."

28. Accordingly, civil appeals filed by the Department stand allowed, the impugned judgments of the High Court are set aside and the matters are remitted to A.O. for fresh disposal of the cases in accordance with the judgment of this Court in *A.M. Moosa* (supra). No order as to costs.

Processing and Negative Profits (loss)

Civil Appeal No. of 2007 arising out of S.L.P.(C) No.12609 of 2004.

29. Leave granted.

30. Assessee is a company engaged in cashew business.

31. For the assessment year 1993-94 assessee did not include processing charges in its total turnover for computing deduction under Section 80HHC of the I.T. Act.

32. Assessee adjusted its losses from export of trading goods against profits from export of manufacturing goods for determining its export profits.

33. Therefore, two following questions arise for determination:

> "Whether processing charges were includible in the "total turnover" in the formula in Section 80HHC(3), as it stood at the material time, for computing deduction under Section 80HHC of the I.T. Act."

> "Whether in the matter of computation of deduction, under Section 80HHC(3)(c) of the I.T. Act, losses suffered by the taxpayer in the export of trading goods can be set off/adjusted against profits

from export of manufactured goods and *vice versa* and whether the assessee would be entitled to deduction if after such adjustments/set off the net figure is a loss." A

34. For the reasons given hereinabove, we answer both the above questions in favour of the Department and against assessee. Accordingly civil appeal filed by the Department is allowed, the impugned judgment of the High Court is set aside and the matter is remitted to A.O. for fresh disposal of the case in accordance with law declared hereinabove on both the points. No order as to costs. B

Civil Appeal No.3167 of 2006 C

35. In view of the Judgment in *Commissioner of Income Tax, Coimbatore* v. *M/s. Lakshmi Machine Works,* (2007) 6 Scale 168, Civil Appeal No.3167 of 2006 filed by the Department is accordingly dismissed with no order as to costs. D

D.G. Appeals disposed of.