CASE NO.:
Appeal (civil) 6146 of 2005

PETITIONER:
Commissioner of Income-Tax Thiruvananthapuram

RESPONDENT:
M/s Baby Marine Exports, Kollam

DATE OF JUDGMENT: 30/03/2007

BENCH:
Ashok Bhan & Dalveer Bhandari

JUDGMENT:
J U D G M E N T
WITH
CIVIL APPEAL NOS.281-284 & 286 OF 2006

Dalveer Bhandari, J.

The controversy involved in these appeals revolves around a short but important question of law - whether the export house premium received by the assessee is includible in the "profits of the business" of the assessee while computing the deduction under Section 80HHC of the Income Tax Act, 1961?

Since a common question of law arises for consideration in these appeals, therefore, they are being disposed of by this common judgment. However, for the sake of reference, the essential facts of Civil Appeal No. 6146 of 2005 are reproduced as under.

The respondent-assessee, M/s Baby Marine Exports, Kollam is engaged in the business of selling marine products both in domestic market and also exporting it. The assessee is exporting directly to the buyers and also through export houses.

The assessee in the instant case has entered into contracts with the export houses, whereby, as and when the assessee sells the goods or merchandise to an export house, as consideration for the sale, receives the entire F.O.B. value of the exports plus the export house premium of 2.25% of the F.O.B. value. The relevant clause dealing with F.O.B. value and incentive commission of the contract entered into between the assessee and the export house in this case is reproduced as under:

"Clause (12): The Export House agrees to pay the manufacturer/shipper an incentive of 2.25% on the F.O.B. value (net of overseas commission) of the said Frozen Marine products shipped by the manufacturer/shipper."

The assessee has been filing its income tax returns showing the export house premium as part of its total turnover and, thereby seeking deductions available to an exporter and/or a supporting manufacturer under Section 80-HHC (1A) of the Income Tax Act.

The assessee has shown the export premium as

part of sale consideration having an element of turnover and not commission or service charges.

The Income-tax Officer, Ward-I, Quilon rejected the claim of the assessee by his order dated 30.3.1995. In this connection, the assessing officer referred to the relevant clause 12 of the agreement entered into between the assessee and the export house and observed that the narration of the clause shows the nature of the payment. According to the assessing officer, this is clearly a "commission or service charge" for routing the exports through the export houses who receive import licenses required by them. The assessing officer in support of his findings referred to and relied upon the decision of ITAT, Cochin Bench in ITA No.610 (Coch)/1994) dated 21.12.1994 in G. Gangadharan Nair v. ITO Ward-1, Mattanchery.

The respondent assessee aggrieved by the said order filed an appeal before the Commissioner (Appeals).

The Commissioner (Appeals) also examined the main question being whether the export house premium will form part of the export turnover for the purpose of computing the amount of deduction under the proviso to sub-section (3) to Section 80HHC?

The Commissioner (Appeals) relying upon the decision of the ITAT dated 28.3.1995 in Income Tax Officer v. Sea Pearl Industries Ltd. directed the assessing officer to include the value of export through export houses also in the export turnover for the purpose of computing deduction under Section 80HHC. The Commissioner (Appeals) held that "what the appellant has received is only a reimbursement of certain expenses or payments towards commission or brokerage. That being the case, the export premium receipts will fall within the ambit of clause 1 of Explanation (baa) to Section 80HHC and, therefore, the Assessing Officer was justified in excluding 90% of such receipts to arrive at the profit of the business as defined in Explanation (baa)". The Commissioner (Appeals) further held that "the Assessing Officer was not justified in excluding the indirect export from the export turnover. He is directed to include the indirect export also in the export turnover for the purpose of Section 80HHC".

The respondent aggrieved by the order of the Commissioner (Appeals) approached the Income Tax Appellate Tribunal.

The Tribunal extracted the findings of the Commissioner (Appeals) in its order in extenso and relied on the decision of the Tribunal.

The Tribunal allowed the appeal of the assessee and upheld the stand of the assessee that the export house premium received by the assessee is includible in the "profits of the business" of the assessee while computing the deduction under Section 80HHC of the Income Tax Act, 1961.

Being aggrieved by the decision of the Tribunal, the Revenue went in appeal before the High Court. The High Court vide order dated 22.8.2003 dismissed the appeal of

the Revenue by observing that the questions involved in the appeal were squarely covered by its decision in ITA Nos.251/2002 and 166/2002 dated 01.7.2003, which were decided in favour of the assessee and against the Revenue. In those cases, the High Court had meticulously examined the issues involved in these appeals. While answering the questions involved, the High Court had observed as under:

"In the present case the assessee is getting the deduction not by virtue of the provision of S. 80-HHC (1) but only by virtue of the provision of S. 80-HHC(1A). The said sub-section provides that 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 or trading house has issued a certificate under the provision to sub-section (1), there shall in accordance with and subject to the provisions of Section 80-HHC 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 trading house in respect of which certificate has been issued. From the above, it would appear that it is the sale of goods or merchandise to the export house which entitles the assessee to get the deduction under the sub-section and it is the profits derived by the assessee from the sale of goods or merchandise to the export house that is liable to be deducted in the computation of the total income. It is only by virtue of the agreements between the assessee and the export houses the assesses got the FOB value of the goods exported and a percentage of the FOB value as export premium. Thus, both the amounts constituted the consideration received by the assessee for the sale of goods or merchandise to the export house. Thus, even applying the principles laid down by the Supreme Court and of this Court in the decisions relied on by the senior counsel for the Revenue, it has to be held that the assesses are entitled to the benefits of section 80HHC on the export premium received from the export houses."

Being aggrieved by the decision of the High Court, the Revenue has come to this Court by way of filing the instant appeal.

The Revenue has raised many questions of law in this appeal, but we are only concerned with the following question:

"Whether, on the facts and in the circumstances of the case, the assessee is entitled to any benefit on the export house premium?"

In appeal, it has been stated by the Revenue that the High Court has erred in law in holding that the premium received by the assessee from the export house, which has exported the goods on behalf of the assessee,

being the supporting manufacturer, was profit on which the assessee was entitled to a benefit of deduction under Section 80-HHC of the Act inasmuch as it did not form part of the sale proceeds of the goods exported by the assessee through the export house but it was merely a receipt from the Export House in consideration of the permits/service rendered to them for facilitating the export of goods.

According to the Revenue, the High Court has erred in interpreting the term "profits of the business" contained in clause (baa) of Explanation to Section 80-HHC by holding that the premium received by the assessee from the export house was profits of business and not any sum referred to in clauses (iiia), (iiib) and (iiic) of Section 28 or any receipt by way of brokerage, commission, interest, rent, charges or any other receipt of similar nature included in such profits. It has been further stated that on a proper construction of provisions of sub-section (1A) and (4A) of Section 80-HHC, the assessee being a supporting manufacturer is entitled to deduction under this Section only on the sale price of the assessee's goods exported through the export house inasmuch as the premium received by the assessee from the export house cannot be held to have been "derived from" the export business of the assessee.

It was asserted by the appellant that the High Court erred in holding that the assessee was entitled to deduction under this Section by ignoring the provisions of sub-section (4A) of Section 80-HHC according to which the assessee being the supporting manufacturer was required to furnish a certificate from the Chartered Accountant that the deduction has been correctly claimed by him on the basis of the profits in respect of the sale of goods to the export house and also a certificate from the export house about disclaimer of deduction in respect of export turnover mentioned in the certificate which could not in any way be construed as including the premium paid by the export house to the assessee.

Shri Vikas Singh, learned Additional Solicitor General appearing on behalf of the Revenue contended that to properly comprehend the issues involved in this case, it is necessary to state in brief the object and the source of money which is passed on by the export house to the supporting manufacturer. The assessment years involved in the present case are 1992-93 to 1994-95. During the relevant years, the EXIM Policy of Ist April, 1992 to 31st March, 1997 was applicable. According to the said policy, export houses were given various benefits both tangible and intangible under the EXIM Policy, some part of the said policy is reproduced as under:

"Under Chapter 12 of the EXIM Policy of 1992-97 vide para 137, the exporting organizations were given recognition as export house/trading house or star trading house on the basis of average FOB value of physical exports done by them during the three preceding licensing years. In the original EXIM policy, an export organization was declared an export house if it did 6 crores of annual net foreign exchange export in the three preceding years and it was declared a trading house if it did 30 crores of the same

and star trading house if it did 125 crores of the same.

In the year 1993, the status determined was done on the basis of average FOB value of physical exports done during the preceding three licensing years. For export houses, it was 10 crores, for trading houses it was 50 crores and for star trading houses it was 250 crores.

In the next year i.e. in 1994, the policy provided both options i.e. of average net foreign exchange export/average FOB value as the basis for declaration of export house, trading houses etc. and in the year 1994 a new category was added which was super star trading houses.

Consequent to the recognition as an export house/trading house/star trading house/super star trading house, the export house was eligible to become a member of the elite Indian Organization namely Federation of Indian Export Organization (FIEO) which further entitled the export houses to attend the various buyers/seller meet all over the world, to participate in the international exhibitions and as members of delegation with the government and also to attend international conferences etc. The benefits were many, only some illustrations have been given above."

Thus, in effect the money which was paid by the export houses to the supporting manufacturers in the form of premium/incentive is nothing but the money which was received by the export houses in the form of one incentive or the other, some of which is cash in the sense that the same can be freely sold in the market at a premium and the others are long term benefit which accrue to the export houses over the years.

The source of the money accordingly is within India and the money paid by the export houses to the supporting manufacturer has no nexus or link to the foreign buyers who paid the value of the goods on being sold to the supporting manufacturer through the export houses. The assessee, i.e., the supporting manufacturer would be entitled to claim the incentive/premium as part of its export turnover if the origin of the money had been the foreign buyer even if the said money were to be routed to the supporting manufacturer through the export house. Since the admitted case of the parties is that the source of money is within India i.e. out of the incentives being offered by the Government of India under the EXIM Policy 1992-97, the turnover of the assessee/supporting manufacturer is merely a domestic turnover and not the export turnover as claimed by them.

The appellant submitted that under Section 80-HHC, the assessee supporting manufacturer is entitled to claim deduction only out of the profits earned by it from the export turnover and not from the domestic turnover which the assessee may have over and above the export

earnings.

Learned Additional Solicitor General also made the following submissions.

(a) The fact that the foreign buyer pays the value of the goods in convertible foreign exchange whereas, the money which is being paid by the export house as premium to the supporting manufacturer is in Indian currency and the said Indian currency has no link or nexus whatsoever with any foreign exchange earning.

(b) The export premium being earned by the assessee is not part of the sale price or the invoice price of the goods being sold by the assessee to the foreign buyer but is in effect something over and above the same.

(c) The amount which is being claimed by the assessee as incentive/premium to be included in his export profit under Section 80HHC is not included in the certificate issued by the export house or trade house under sub-section (1A) of Section 80HHC and hence the assessee cannot claim any benefit for the said amount being outside the scope of deduction under Section 80HHC (1A).

The assessee cannot get the premium/incentive included as his profits under Section 80-HHC because even the export house that is passing on this premium to the assessee/supporting manufacturer is not permitted to claim such deduction as profit from export earning under Section 80-HHC. In terms of Explanation (baa) to Section 80HHC sub-clause 4(A), even the export house can only claim 10% of such or similar earnings towards deduction and hence it is inconceivable that the supporting manufacturer could be permitted to claim 100% deduction of the same money when it comes into his hands. Finally, learned Additional Solicitor General argued that the premium earned by the assessee is the domestic earning of the assessee totally unrelated to the export of goods and hence the assessee cannot claim any deduction whatsoever in respect of such earning under Section 80-HHC (1A).

Shri S. Ganesh, learned senior Advocate appearing for the respondent - assessee contended that the claim of the assessee for deduction under Section 80-HHC is by virtue of the provision of Section 80-HHC (1A). He also submitted that as far as the assessee is concerned, the export premium forms part of the export transaction between the assessee and the export houses and, therefore, it forms part of the export transaction and consequently, the income by way of export premium is profit derived by the assessee from the export of such goods or merchandise.

The export premium received by the assessee from the export house forms part of the price settled between the parties for sale of the goods and that it is neither brokerage nor commission nor interest nor rent nor charges etc.

Mr. Ganesh, referred to the decision of Bombay

High Court in CST v. Bangalore Clothing Company reported in 260 ITR 371 wherein the Bombay High Court has referred to and followed the Circular No.621 issued by the CBDT dated 19th December, 1991. The High Court has explained that the object of the Explanation (baa) to Section 80-HHC is to exclude profit receipts from the business which do not have an element of turnover and which are not connected with the assessee's business operations. If a particular receipt is in the nature of the operational income then it must be included in business profit and consequently benefits of Section 80-HHC must be granted in respect thereof. Mr. Ganesh also urged that applying the test enunciated by the judgment of the Bombay High Court in Bangalore Clothing Company's case (supra) would lead to irresistible conclusion that the export house premium must necessarily be included in the business profit because it is part of the assessee's turnover and has an integral connection with the business operations of the supporting manufacturer, which consist of sale of goods of the export house.

Mr. Ganesh submitted that the judgment delivered by the Madras High Court in KRN Marine Exports Ltd. v. ACIT reported in 2006 (153) Taxman p.437 is not good law as the said decision did not consider the Board Circular No. 621 which explained the clarification of the provision of the Explanation (baa) to Section 80HHC (1A) of the Act. In that case, the High Court completely failed to appreciate the crucial distinction between Section 80HHC (1) and Section 80HHC (1A) and also the fact that the supporting manufacturer's claim for the deduction was under Section 80HHC (1A) which has nothing whatsoever to do with export profit, with which only the export house is concerned. Mr. Ganesh also contended that the said decision is required to be overruled by this Court in view of the decision of this court in Berger Paints India Ltd. v. Commissioner of Income Tax, Calcutta reported in (2004) 12 SCC 42.

We have heard the learned counsel for the parties at length. Before critically examining the rival contentions of the learned counsel for the appellants and the respondents, we deem it appropriate to refer to the provisions of Section 80-HHC of the Act:

"80HHC. Deduction in respect of profits retained for export business. (1) Where an assessee, being an Indian company or a person (other than a company) resident in India, is engaged in the business of export out of India of any goods or merchandise to which this section applies, there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction to the extent of profits, referred to in sub-section (1B), derived by the assessee from the export of such goods or merchandise:

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 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 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 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 to the extent of profits, referred to in Sub-section (1B)], derived by the assessee from the sale of goods or merchandise to the Export House or Trading House in respect of which the certificate has been issued by the Export House or Trading House.

Section 80HHC was incorporated with the object of granting incentive to earners of foreign exchange. This Court in Sea Pearl Industries v. CIT Cochin (2001) 2 SCC 33 also observed that the object of Section 80HHC is to grant incentive to earners of foreign exchange. In IPCA Laboratory Ltd. v. Dy. Commissioner of Income Tax, Mumbai reported in (2004) 12 SCC 742 this Court has taken the same view. This Court in the said judgment observed that Section 80HHC has been incorporated with a view to provide incentive to export houses and this Section must receive liberal interpretation.

In Bajaj Tempo Ltd. v. Commissioner of Income Tax, Bombay reported in (1992) 3 SCC 78, this Court while interpreting Section 15-C of the Income Tax Act, 1922 observed that the Section, read as a whole, was a provision, directed towards encouraging industrialization by permitting an assessee setting up a new undertaking to claim benefit of not paying tax to certain extent on the capital employed. Similarly, Section 80 HHC has also been incorporated to give incentive for the earners of the foreign exchange. We must always keep the object of the Act in view while interpreting the Section. The legislative intention must be the foundation of the court’s interpretation.

According to Section 80HHC (1), the Export House in computing its total income is entitled to deduction to the extent of the profit derived by the assessee from the export of the goods or merchandise. Whereas, according to Section 80 HHC(1A), the supporting manufacturer shall be entitled to a deduction of profit derived by the assessee from the sale of goods or merchandise. The term "supporting manufacturer" has been defined in this section and it reads as under:-

"supporting manufacturer" means a person being an Indian 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; According to the said definition, the respondent clearly comes within the purview of supporting manufacturer. On plain construction of Section 80HHC(1A) the assessee being supporting as manufacturer shall be entitled to a deduction of the profit derived by the assessee from the sale of goods or merchandise."

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The respondent \026 a supporting manufacturer sold the goods or merchandise to the export house and received the entire FOB value of the goods plus the export house premium of 2.25% of the FOB value. The relevant Clause 12 of the agreement has already been extracted in the earlier part of the judgment and according to the said clause, the export house is under obligation to pay to the supporting manufacturer an incentive of 2.25% on the F.O.B. value according to the terms of the agreement.

The respondent, a supporting manufacturer, admittedly sold the goods to the export house in respect of which the export house has issued a certificate under proviso to sub-section (1). According to the section, the respondent - assessee, in computing the total income be allowed a deduction to the extent of profits referred to in sub-section (1B) derived by the assessee from the sale of goods to the export house.

The Appellate Tribunal has arrived at definite conclusion that the Export House Premium is nothing but an integral part of sale price realized by the assessee \026 a supporting manufacturer from the Export House. The Tribunal further held that the Export House Premium cannot possibly be considered to be either commission or brokerage, as a person cannot earn commission or brokerage for himself.

The High Court has upheld the findings of the Tribunal. In our considered view, the order of the Appellate Tribunal is based on proper construction of Section 80HHC (1A) of the Income Tax Act that the Export House premium is an integral part of the sale price realized by the assessee from the export house.

We find no merit in the submission of the appellant that Indian currency could not be subject matter of deduction under Section 80HHC. The requirement of realizing the sale proceeds of the goods or merchandise in convertible merchandise is applicable only to the Export House and a claim for deduction under Section 80HHC (1). The requirement of realization of sale proceeds in foreign exchange expressly made inapplicable to the supporting manufacturer by Section 80HHC(2A) and further the supporting manufacturer’s claim of deduction is only under Section 80HHC(1A) and not under Section 80HHC(1) which applies to export houses only.

The submission of the appellant that the premium earned by the respondent assessee is totally unrelated to export is fallacious and devoid of any merit. This submission of the appellant is also contrary to the specific terms of the agreement between the appellant and the respondent.

On plain construction of Section 80HHC (1A), the respondent is clearly entitled to claim deduction of the premium amount received from the export house in computing the total income. The export house premium can be included in the business profit because it is an

integral part of business operation of the respondent which consists of sale of goods by the respondent to the export house.

The order of the Tribunal, which has been upheld by the High Court in the impugned judgment, is based on proper construction of Section 80HHC of the Income Tax Act, 1961. The appeal filed by the appellant being devoid of any merit is accordingly dismissed.

CIVIL APPEAL NOS.281-284 & 286 OF 2006

These appeals stand disposed of in terms of our judgment in Civil Appeal No. 6146 of 2005.

In the peculiar facts and circumstances of the case, we direct the parties to all the appeals to meet their respective costs.