IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCHES "E", MUMBAI

BEFORE SHRI I. P. BANSAL, J.M. AND SHRI SANJAY ARORA, A.M.

ITA No. : 7127/Mum/2010
Assessment Year: 2005-06

Tessitura Monti India (P.) Ltd. 401, Trade Avenue, Suren Road, Andheri (E), Mumbai-400 093 [PAN NO.: AABCT 3524 E]	Vs.	ITO – 8(3)(3), Mumbai
(Appellant)		(Respondent)

Appellant by : Shri Nitesh Joshi
Respondent by : Shri V. Krishnmoorthy

Date of hearing : 06.12.2012
Date of Pronouncement : 11.01.2013

O R D E R

Per Sanjay Arora, A.M.:

This is an Appeal by the Assessee directed against the Order by the Commissioner of Income Tax (Appeals)–18, Mumbai ('CIT(A)' for short) dated 10.08.2010, partly allowing the assessee's appeal contesting its assessment u/s.143(3) of the Income Tax Act, 1961 ('the Act' hereinafter) for the assessment year (AY) 2005-06 vide order dated 27.03.2008.

2. The only issue in appeal is the eligibility of various incomes, credited to the account head 'other income' by the assessee in its books of accounts, for being considered as part of the profits derived by the assessee from an eligible

undertaking from export of articles or things or computer software for the relevant year and, thus, subject to deduction u/s.10B of the Act. The same stood excluded by the Assessing Officer (A.O.) relying on the decisions by the hon'ble apex court, as in the case of *Pandian Chemicals Ltd. vs. CIT* (2003) 262 ITR 278 (SC); *CIT vs. Sterling Foods Ltd.* (1999) 237 ITR 579 (SC) and *Indian Leather Corporation Ltd. vs. CIT* 222 ITR 552 (SC). In appeal, the same stood confirmed by the ld. CIT(A), discussing each of the incomes in detail and distinguishing the case law relied upon by the assessee, while at the same time also adverting to certain decisions. Aggrieved, the assessee is in second appeal.

3.1 Before us, the learned AR would seek to distinguish each of the decisions relied upon by the ld. CIT(A) with reference to the language of section 10B as it stands post amendment by Finance Act, 2000 w.e.f. 01.04.2001, i.e., A.Y. 2001-02 onwards. All the decisions, saving one, relied upon by the first appellate authority have been rendered under the pre-amended provision, which did not bear a provision corresponding to section 10B(4), which reads as under :-

> *"***Special provisions in respect of newly established hundred per cent export-oriented undertakings**"
>
> ***10B.****(1)* ……
>
> *(2)* ……
>
> *(3)* ……
>
> *(4) For the purposes of sub-section (1), the profits derived from export of articles or things or computer software shall be the amount which bears to the profits of the business of the undertaking, the same proportion as the export turnover in respect of such articles or things or computer software bears to the total turnover of the business carried on by the undertaking."*

Clearly, he continued, what is envisaged is only an adjustment toward domestic business, i.e., *qua* goods or computer software, so that the profit stands to be a proportioned in the ratio of export turnover (ET) (or the relevant turnover) to the total turnover (TT). That being the case, no further adjustment, as sought to be made by the Revenue, is called for. The Tribunal has in fact accepted this position, and for which he would place reliance on the decisions in the case of *Jewelex International P. Ltd.* (in *ITA No.3302/Mum./2009* dated 15.09.2010 / copy on record), adverting our attention to para 5 thereof. Apart from the fact that the said decision stands rendered in relation to one of the items under reference in the instant case, i.e., interest on margin money deposited with bank for availing credit facilities, the said case is also applicable in ratio, inasmuch as it holds that section 10B(4) prescribes a statutory formula, so that once a particular income forms part of the profits of the business of the undertaking, this ratio (apportionment) shall follow, leaving in fact no choice in the matter. There is no provision corresponding to section 10B(4) in the other provisions, viz. sections 80I, 80IA, 80HH, et. al., where-under the issue has been considered by the hon'ble courts, even as observed by the tribunal in the said case. The other decisions relied upon by the ld. CIT(A), albeit in the context of other incomes excluded in the instant case, are rendered under pre-amended section 10B. The only decision relied upon in relation to the post amended law, i.e., in the case of *India Comnet International vs. ITO* (Mad) 304 ITR 322, though being in relation to A.Y. 2002-03, is yet not based on the same, i.e., the law post amendment, as the change in section 10A (a corresponding provision, also containing - w.e.f. 01.04.2001 - a statutory formula as specified in section 10B(4), in section 10A(4)) was not brought to the notice of the hon'ble court, which only followed its earlier decision in case of *CIT vs. Menon*

Impex Pvt. Ltd. (2003) 259 ITR 403, wherein the assessment year involved was A.Y. 1985-86.

3.2 The ld. DR, on the other hand, would submit that all the clauses of section 10B, other than section 10B(1), are only procedural in nature, and would not go to alter or detract from the basic premise of section 10B(1), the core provision, which provides or lays down the foundation as well as the ambit of the deduction, which would, thus, continue to be governed thereby (i.e., section 10B(1)). The said sub-sections, including section 10B(4), must, therefore, be read in harmony and not in derogation of section 10B(1).

4. We have heard the parties, and perused the material on record, as well as the case law cited.

4.1 Though both the parties have relied extensively on case law, the same (other than in the case of *Jewelex International P. Ltd.* (supra)), is primarily and essentially toward inclusion or otherwise of various incomes in computing the profits exigible to deduction u/s.10B(1), though rendered under the various other provisions. The scope and ambit of section 10B(4), with reference to which the assessee pleads its case before us, has not been dealt with except by the tribunal in the case *Jewelex International P. Ltd.*(supra), vide para 5 of its order, the contents of which stands enumerated at para 3.1 of this order. It would, therefore, be both necessary and relevant for us to consider this aspect of the matter first, so as to considered the expanse of the word 'derived' occurring in section 10B(1) in the context of section 10B. That is, we find merit in the assessee's contention of the said section requiring a revisit in view of the provision being recast by Finance

Act, 2000, though it cannot be said that the same was attempted in the case of *Jewelex International (P.) Ltd.*(supra).

4.2 Section 10B, in its relevant part, reads as under:-

> ***"10B.*** *(1) Subject to the provisions of this section, a deduction of such profits and gains as are derived by a hundred per cent export-oriented undertaking from the export of articles or things or computer software for a period of ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or things or computer software, as the case may be, shall be allowed from the total income of the assessee:*
>
> ***Provided*** *that where in computing the total income of the undertaking for any assessment year, its profits and gains had not been included by application of the provisions of this section as it stood immediately before its substitution by the Finance Act, 2000, the undertaking shall be entitled to the deduction referred to in this sub-section only for the unexpired period of aforesaid ten consecutive assessment years :*
>
> ***Provided further*** *that for the assessment year beginning on the 1st day of April, 2003, the deduction under this sub-section shall be ninety per cent of the profits and gains derived by an undertaking from the export of such articles or things or computer software:*
>
> ***Provided also*** *that no deduction under this section shall be allowed to any undertaking for the assessment year beginning on the 1st day of April, 2012 and subsequent years:*
>
> *(2) This section applies to any undertaking which fulfils all the following conditions, namely:—*
>
> *(i) it manufactures or produces any articles or things or computer software;*
>
> *(ii) it is not formed by the splitting up, or the reconstruction, of a business already in existence :*

Provided *that this condition shall not apply in respect of any undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section ;*

(iii) it is not formed by the transfer to a new business of machinery or plant previously used for any purpose.

Explanation.—The provisions of Explanation 1 and Explanation 2 to sub-section (2) of section 80-I shall apply for the purposes of clause (iii) of this sub-section as they apply for the purposes of clause (ii) of that sub-section.

(3) This section applies to the undertaking, if the sale proceeds of articles or things or computer software exported out of India are received in, or brought into, India by the assessee in convertible foreign exchange, within a period of six months from the end of the previous year or, within such further period as the competent authority may allow in this behalf.

Explanation 1.— For the purposes of this sub-section, the expression "competent authority" means the Reserve Bank of India or such other authority as is authorized under any law for the time being in force for regulating payments and dealings in foreign exchange.

Explanation 2.—The sale proceeds referred to in this sub-section shall be deemed to have been received in India where such sale proceeds 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.

(4) For the purposes of sub-section (1), the profits derived from export of articles or things or computer software shall be the amount which bears to the profits of the business of the undertaking, the same proportion as the export turnover in respect of such articles or things or computer software bears to the total turnover of the business carried on by the undertaking."

4.3 It would, thus, appear to us that the process of determination of quantum of profits derived *by* a 100% E.O.U. *from* the relevant exports would involve three steps. The section applies only to an eligible undertaking, i.e., a 100% E.O.U.,

receiving export proceeds in convertible foreign exchange. As such, the first step would be to ascertain if the assessee's undertaking is an eligible undertaking u/s.10B. The *profits of the business of the undertaking* would be required to be computed as the second step, which represents the most crucial step. This is as it provides for the profits derived by an undertaking from the export of articles or things or computer software to be the profits of the business of the undertaking in a defined ratio, i.e., that of 'ET' to 'TT'. The expression '*profit of the business of the undertaking*' is not defined under the provision. One thing, however, is clear; that the third step, i.e., the adjustment by way of apportionment of such profit in the ratio of 'ET' to 'TT' is toward further limiting the profits of the business of the undertaking to that derived from exports only. This is as the eligible profits must be firstly derived by the undertaking and, secondly, from its exports (s. 10B(1)). *And it is this, the third step, that sec. 10B(4) is toward*. Also, as a 100% E.O.U is licensed to undertake only exports, the other element of TT would normally include either the export proceeds that are not brought into India within six months (or such extended period as may be allowed) or the sale proceeds of a part of its production that it could under the terms of the 100% EOU license sell in the domestic market, or the sale of other products (of the assessee's undertaking) which arise incidentally to its operations in the domestic market. In fact, the second *proviso* to the provision is only by Finance Act 2002, w.e.f. 01/4/2003; its earlier version, since omitted, bearing a tolerance of up to 25% of the total sales for domestic turnover.

Coming to the second step afore-said, the words 'business of the undertaking' are wider in ambit than the words 'profit of the undertaking' and could only have been so provided with a purpose. In our considered view, therefore, any profit which is derived from the business of the assessee's

undertaking would qualify to be the profits of the business of the undertaking, and upon suitable apportionment toward excluding as much of it as can be regarded as attributable to the domestic turnover or non-qualified exports, can be said to be the profits derived by the 100% E.O.U from exports, as contemplated in section 10B(1), and on which deduction there-under is to be allowed. All that was required, if not so, was to define the profits of the business to mean the profits of the eligible business as computed under the head 'profits and gains of business or profession'. *In other words, the word 'derived' would continue to control or guide the word 'profits' in the deduction provision, but the activity from which the same are derived is the economic activity that comprises the business of the eligible undertaking, rather than being restricted strictly to the eligible undertaking*. As such, as long as a receipt is intimately and inextricably connected with the 'business of the undertaking', it cannot be excluded in reckoning the eligible profits u/s. 10B(1).

We may clarify though, that, by virtue of the foregoing analysis, we do not in any manner purport to explain or delineate the scope of the word 'derived', which stands conclusively defined as implying a relation of first degree by the hon'ble apex court on a number of occasions, as per its decisions listed at para 2 above, to which its recent decision in the case of *Liberty India vs. CIT* (2009) 317 ITR 218 (SC) may also be added (also refer para 4.4(c) *infra*). The purport of the present exercise was only to address the assessee's argument with reference to section 10B(4) and, in result, leads us to state that the said relation, i.e., of first degree, as envisaged by the provision, is contemplated to be with the business of the eligible undertaking. Further, we have, in arriving at our afore-said view, also gone through the pre-amended provision of s. 10B, under which most of the case law relied upon by the Revenue, stands delivered, and in respect of which the

assessee's case is of a change in law inasmuch as the earlier provision did not contain a clause as prescribed u/s. 10B(4). Though no formula, as later incorporated per s. 10B(4), stood provided prior to the amendment per Finance Act, 2000, this was for the reason that the entire income stood exempt, while the later version contemplates a *deduction* based on the relevant (export) turnover, and which we have found to be the sum and substance of sec. 10B(4). Further, the amended provision, per sub-section (3), specifies the condition of the export being in convertible foreign exchange and bringing the export proceeds into India within six months (from the end of the relevant previous year) as a condition precedent for the application of the section itself. In fact, section 10B(4), as it now stands, is itself as substituted by Finance Act, 2001, w.e.f. 1/4/2001, prior to which it read as:

> ***"10B.*** *(4) For the purposes of sub-section (1), the profits derived from export of articles or things or computer software shall be the amount which bears to the profits of the business, the same proportion as the export turnover in respect of such articles or things or computer software bears to the total turnover of the business carried on by the assessee."*

The subsequent amendment, though, comes into effect from the same date (01/4/2001), so that sub-section (4) of sec. 10B, as substituted earlier by Finance Act, 2000 never came to be operative. It, nevertheless, brings forth the intention in restricting the eligible profits to that of the business of the undertaking only, i.e., the business carried on by the assessee through the eligible undertaking. Apart there-from, we find the pre-amended section to be cast in almost the same terms; the significant variation being in extending the benefit to export of computer software and in diluting it to a 'deduction' provision as against, as also afore-noted, an 'exemption' provision earlier. The section, as earlier, applies only to an eligible undertaking, and *qua* the profits derived thereby (s. 10B(1)). To this extent the

decisions rendered in the context of other cognate provisions as well as the pre-amended s. 10B, and relied upon by the Revenue, would hold. With regard to the working of the same, we have already noted that the words 'of the business of the undertaking' to be wider in ambit than the words 'of the undertaking' or 'derived from the undertaking'; also clarifying our understanding of the import of the same.

4.4 We may now proceed to examine each of the incomes under reference:

a) *Interest on monies held in FD with bank for availing credit facilities by way of LC and bank guarantee (Rs.13,92,945/-)*:

It is not clear if monies held in deposit account/s form part of the regular arrangement adopted or followed by the bank for extending non-fund based credit facilities to its constituents. If so, the same can only be regarded as integral to the assessee's business, forming part of the profits of the business of the assessee's eligible undertaking, even as held by the tribunal on more than one occasion. The receipt though arising in India directly impacts the input cost of goods or services required for carrying on the export business, if not the availability of those goods and services themselves. However, if these (deposits) serve only or principally as a collateral for availing the facilities, in which case these could well be substituted with any other security as mutually acceptable to the lender-bank and the borrower, the position would be different. This has been the subject matter of many a decision by the superior courts. As explained in *CIT v. Jose Thomas*, 253 ITR 553 (Ker.), though rendered in the context of s. 80HHC, in relation to bank deposits held as collateral security for bank borrowings, reversing the decision by the tribunal in the matter, that if agricultural land stood offered as a collateral security, going by the tribunal's logic, the agricultural income there-from would be assessable as business income! (pg. 560). Though the issue here is not of the head of income under which

the income would be assessable, its boils down to ascertaining if the interest income under reference is an independent receipt (which the income from the collateral security was found to be) or not. Subject to verification on this count by the AO, and returning a positive finding of the deposits not serving merely as a collateral, but extended as a part of a normative business arrangement by the bank with its clients for allowing such non-fund facilities for their business, the assessee's claim is allowed.

b) *Interest on FD and bank on surplus funds (Rs.2,71,217/-)*: Even as admitted by the ld. counsel during hearing, the same is only on surplus funds for the time being and, therefore, cannot be said to be derived from the assessee's business. The same stands rightly excluded.

c) *Sales tax refund (Rs. 25,91,659) and excise duty draw back (Rs.5,92,095)*: The same represents refund of sales-tax on purchases for an earlier period, being not payable by an export unit. The said benefit is only a part of the receipt of the business. No doubt, it arises from a government policy toward non-levy of tax on the purchases meant for export, is yet only to provide an incentive to the export business by making it more competitive in the international market, by reducing the input cost. The same would, thus, have to be regarded as an eligible receipt of the eligible business. Likewise for the duty draw back. This was the sum and substance of the assessee's case before us, pleaded by the ld. AR with reference to the relevant grounds (Gd. Nos. V(B)(i) (d,e,f)), as well as the summary of the grounds & submissions before the ld. CIT(A) (PB pgs. 24,30), together for the two receipts. Reference was also made by him to the provision of section 41(1) of the Act to impress that the same forms the income for the current year.

The receipt is without doubt of the assessee's business and, accordingly assessable as 'business income'. *However, the moot point is*: Whether it can be stated to be 'derived' from such business, as we have understood the word 'of' in the expression of 'profits of the business of the undertaking' as signifying a relationship of first degree, i.e., flows from the economic activity comprising the same, or is its direct source a government policy as reflected in the relevant law and/or rules framed there-under. In our view, it is not the business of the undertaking *per se* but the relevant policy of the government that leads to a different treatment of the assessees engaged in exports vis-a-vis those in domestic business and, thus, responsible for the said profit. This issue stands in fact explained at length by the hon'ble apex court in the case of *Liberty India* (supra), where similar arguments, i.e., as in the instant case, were advanced, including with reference to the language of section 80-IB, which uses the same expression '*profits of the business of the undertaking*' as against the '*profits of the undertaking*' in section 80-I. Reference in this regard may be made to the section of the judgment enlisting the arguments at pages 223 to 226. The relevant findings appear at pages 231-234. As such, our reading of section 10B(1) r.w.s. 10B(4) does not admit of receipt, the immediate source of which is not the economic activity itself, but a fiscal incentive, as being profit derived there-from. We find ourselves fully supported by the decision in the case of *Liberty India* (supra), as well as by the tribunal in the case of *ITO vs. V. J. Homes Pvt. Ltd.* [2009] 125 TTJ (Jodhpur) 215, rendered under a cognate provision (section 10BA), also relied upon by the Revenue. In fact, no contrary decision has also been brought to our notice.

d) *Scrap sale (Rs.32,54,701/-)*-: The appellant's case was found not acceptable in view of the decisions in the case of *CIT vs. Sundaram Industries Ltd.* [2002] 253

ITR 396 (Mad) and *Fenner India Ltd. vs. CIT* (2000) 241 ITR 803 (Mad), wherein the claim *qua* scrap sales stood disallowed in the context of sec. 80HH on the ground that the same could not be said to be part of the profits derived from the industrial undertaking. However, the qualifying profits per that provision are as derived from the assessee's industrial undertaking, the ambit of which could only be considered as enhanced by the use of the words 'profits of the business of the undertaking'. The scrap, as explained by the ld. AR, arises out of the manufacturing operations, and only goes to reduce the cost of production. In fact, the same, even where not sold, would necessarily be required to be valued at net realizable value, and which would be the going market rate less incidental costs, if any, and thus to the same, substantial effect. We, thus, could not agree more with the assessee's case, i.e., that its business (per the relevant undertaking) is itself the direct source of the said profit. It is not necessary, as also explained earlier, that every credit or receipt of the export business must arise directly from the export itself, for it to qualify for inclusion, and it would be suffice that the same arises in the course of the assessee's business. Further, the very fact that section 10B(4) provides for an apportionment in the ratio of ET to TT implies that receipts other than that comprised in ET are contemplated for inclusion in TT. The same is, thus, eligible and, further, would go to form part of the TT. We are aware that this aspect does not arise directly before us, but we are constrained to observe so, as the same only follows; rather, forms the basis of our finding of the scrap sales forming part of the receipt of the assessee's export business, i.e., accepting the assessee's case, so that the said profit stands derived from such business. We decide accordingly.

e) *Miscellaneous Income (Rs.1,42,555/-)*

The same comprises the following: (refer PB pg. 30)

Canteen recovery	Rs.46,391/-
Discount	Rs.93,395/-
Fine from workers	Rs. 2,769/-

We are unable to see as how 'canteen recovery' or 'fine from the workers' could be considered as forming an integral part of the assessee's business. The ld. AR, however, would inform us that the credit does not constitute an income *per se*, but only represents recovery (to that extent) out of canteen expenses, which stand already debited and reduced in arriving at the eligible profits. If so, there is no question of it being an item of income, and would only go to reduce a cost, which stands incurred and, secondly, already considered as part of the cost and reduced from the profits of the eligible business, to that extent. The A.O. shall verify the same, and allow relief only to the extent the said amount goes to reduce the relevant expenditure, where already claimed and allowed. No case *qua* fine from workers is, however, made out. The details of the discount would be required to be similarly considered, which we find to have not been by the Revenue. If, as claimed, it comprises Rs.1.04 lakhs received by way of a 1% discount on purchases from a supplier against purchase of raw material there-from, the same is not an independent receipt; rather, only reduces the purchase cost to that extent, though accounted for separately, which though ought not to be of any moment. The assessee's claim, where found to be so, is a part of the profits derived from the eligible business. We decide accordingly.

5. In the result, the assessee's appeal is partly allowed and partly allowed for statistical purposes.

Order pronounced on this 11th day of January, 2013

Sd/- Sd/-

(I. P. BANSAL) (SANJAY ARORA)
JUDICIAL MEMBER ACCOUNTANT MEMBER

MUMBAI, Date: 11.01.2013

Copy forwarded to:

1. The Appellant.
2. The Respondent.
3. The C.I.T.
4. CIT (A)
5. The DR 'E' Bench, ITAT, Mumbai

BY ORDER

ASSISTANT REGISTRAR
ITAT, Mumbai Benches, Mumbai

Roshani