* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **INCOME TAX APPEAL NO. 130/2011**

Reserved on : 15th March, 2012.
% **Date of Decision** : 17th May, 2012.

ESSEL SHYAM COMMUNICATION LTD. .... Appellant
Through Mr. Ajay Vohra, Ms. Kavita Jha, Mr. Somnath Shukla, Advocates.

VERSUS

COMMISSIONER OF INCOME TAX .....Respondent
Through Mr. N.P. Sahni, Sr. Standing Counsel.

\+ **INCOME TAX APPEAL NOS 279/2011 & 284/2011**

COMMISSIONER OF INCOME TAX .... Appellant
Through Mr. N.P. Sahni, Sr. Standing Counsel.

VERSUS

ESSEL SHYAM COMMUNICATION LTD. ...Respondent
Through Mr. Ajay Vohra, Ms. Kavita Jha, Mr. Somnath Shukla, Advocates.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE R.V. EASWAR

SANJIVKHANNA, J.:

ITA 130/2011 preferred by Essel Shyam Communication Ltd. and ITA Nos.284/2011 and 279/2011 preferred by the Revenue arise out of the common order dated 31st March, 2010, passed by the Income Tax Appellate Tribunal (for short, the

tribunal). The appeals pertain to the assessment year 2005-06. We may note that the Revenue has preferred two appeals as there were cross appeals by the Revenue and one by the assessee before the tribunal against the order of the first appellate authority.

2. By order dated 12th July, 2011, the following substantial questions of law were framed in the respective ITAs:-

ITA 130/2011

> "1. Whether on the facts and in the circumstances of the case, the Tribunal erred in law in holding that income earned by the appellant from development of software upgrades for Network Management Systems for smooth and trouble free working of VSAT service provided by the appellant, as part of business of telecommunication services, was not eligible for deduction under Section 80-IA(4(ii) of the Income Tax Act?
>
> 2. Whether on the facts and in the circumstances of the case, the Tribunal erred in law in not directing exclusion of only net interest income, i.e., gross interest income less expenditure incurred for earning such interest income, while computing deduction under Section 80-IA of the Income Tax Act?"

ITA No.279/2011

> "Whether learned ITAT erred in law in holding that INSAT 2E is a domestic satellite within the meaning of sub-clause (ii) of Clause (4) of Section 80-IA of the Income

Tax Act, 1961, despite the fact that British Telecom has leased it to the assessee?"

ITA No.284/2011

"Whether learned ITAT erred in law in holding that income of Rs.50,42,764/- from trading activities is derived from Industrial undertaking within the meaning of Section 80-IA of the Income Tax Act, 1961?"

3. The assessee is a public limited company and was providing satellite based telecommunication solutions including VSAT services, up-linking services, play out services and broadband service through satellite. It had earned income from the said services, besides rental income and income from other sources. In the return of income filed on 28th October, 2005, it had claimed deduction under Section 80IA of the Income Tax Act, 1961 (Act, for short) of Rs.4,88,29,013/- and after the adjustment, had declared total taxable income of Rs. 5,45,89,013/-. The total taxable income under Section 115JB was Rs.6,90,32,533/-.

4. As section 80IA is required to be interpreted and examined, we deem it appropriate to reproduce the relevant portion of the said provision, as it existed during the assessment year period in question:-

> "80-IA **Deductions in respect of profit and gains from industrial undertakings etc., in certain cases.**-(1) Where the gross total income of an assessee includes any profits and gains derived by an undertaking or an enterprise from any business referred to in sub-section (4) (such business being hereinafter referred to as the eligible business), 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 an amount equal to hundred per cent of profits and gains derived from such business for ten consecutive assessment years.
>
> (2) xxxxxxx
>
> (2A) Notwithstanding anything contained in sub-section (1) or sub-section (2), the deduction in computing the total income of any undertaking providing telecommunication services, specified in clause (ii) of sub-section (4Z), shall be hundred per cent of the profits and gains of the eligible business for the first five assessment years commencing at any time during the periods as specified in sub-section (2) and thereafter, thirty per cent of such profits and gains for further five assessment years.
>
> (3) xxxxxxxx
>
> (4) (ii) any undertaking which has started or starts providing telecommunication services whether basis or cellular, including radio paging, domestic satellite service, network of trunking, broadband network and internet services on or after the 1st day of April, 1995, but on or before the 31st day of March, 2005.
>
> *Explanation.*- For the purpose of this clause, "domestic satellite" means a satellite owned and operated by an Indian company for providing telecommunication service."
>
> *(emphasis supplied)*

5. Clause (ii) to Section 80IA (4) quoted above can be bifurcated and divided into several parts. It applies to an undertaking which had started or was providing; (i) telecommunication services whether basic or cellular, (ii) radio

paging (iii) domestic satellite service (iv) network of trunking, (v) broadband network and (vi) Internet service. The dates during which the said services should be started/provided is stipulated. Any company/assessee providing the said services was entitled to claim benefit in respect of income earned i.e., profits and gains derived from the said services. Therefore, the first and the foremost requirement, when a deduction is claimed with reference to clause (ii) of Section 80IA (4), is to determine and decided whether activity undertaken by the assessee is covered by any of categories mentioned in clause (ii) to Section 80IA(4). This aspect has somehow escaped notice of the authorities as well as the tribunal. This has resulted in confusion as the Assessing Officer has made several additions including addition for software sales, domestic satellite services etc. There is no clear and direct finding on the precise nature of the activity undertaken resulting in income earned and whether or not they fall within one of the aforesaid specified categories. To some extent, the assessee is also responsible for the said confusion because of their reply in the course of the assessment proceedings. The Assessing Officer had not appreciated and understood the issue and the proper legal affect of clause (ii) of

Section 80IA (4). As we answer the questions, this aspect becomes apparent.

6. Question No. 1 in ITA No. 130/2011 and the Questions raised in ITA Nos. 279/2011 and 284/2011 are inter-related and are being taken up first. Question No. 2 raised by the assessee in ITANo. 130/2011 will be taken up in the end.

7. Question raised in ITA 279/2011 arises as the Assessing Officer had treated Rs.1,42,34,278/- as income earned by the assessee from domestic satellite service. The reasoning given by the Assessing Officer is difficult to understand and somewhat ingenious. The Assessing Officer referred to notes on accounts in which the assessee had disclosed that payment of Rs.13,42,288/- was made for space segment charges in foreign currency. This payment was made to British Telecom (Worldwide) for use of satellite service in the Indian Satellite INSAT 2E. The Assessing Officer held that the said satellite was not a 'domestic satellite' as it was owned by Department of Space, Government of India, which was not an Indian company and was being operated by British Telecom (Worldwide), a foreign company. The said view, however, was not accepted by the CIT (Appeals), who held that British Telecom (Worldwide) or INTELSAT did not have ownership right over the satellite.

Relying upon the letter dated 21st November, 2007, written by the Director, ISRO, it was held that the satellite was owned by the Department of Space, Government of India and, therefore, the Assessing Officer was not justified in excluding the income earned from the domestic satellite services. The view of the CIT (Appeals) has been affirmed by the tribunal.

8. The Assessing Officer to compute and make the aforesaid addition of Rs.1,42,34,278/- observed that the assessee had made payment of Rs.13,42,288/- to British Telecom (Worldwide) and had not shown any income or receipts earned from any third party. The addition was made holding that the income included income from satellite services not in the nature of domestic satellite service as defined for purpose of the Section 80IA. The profit/income disclosed by the assessee was notionally on proportionate basis treated as profit/income earned from satellite services, not being domestic satellite services.

9. The assessee holds a VSAT license to establish, maintain and operate closed users group, an Internet license to establish, maintain and operate internet services and a license/permission from the Ministry of Information and Broadcasting for providing uplinking services. The case of the assesse is that they have incurred an expenditure for utilization of space segment on a

satellite to provide the said services. It is not their case that they are in the business of providing lease/ sale of space segment or satellite services or that they were providing domestic satellite services. Contention of the assessee was/is that as a broadband/internet service provider etc. it had procured space segment in the satellite and paid charges in foreign currency for utilizing space segment. It was an expense, which was incurred and not that any income was earned. The question is not whether any expense was incurred in respect of the services stipulated in clause (ii) of Section 80IA (4), but whether the assessee has earned income derived from the specified services. It is not the case of the assessee that it was providing domestic satellite services and earning income from the said activity. The term “domestic satellite” as defined in the explanation means the satellite owned and operated by an Indian company for providing telecommunication services. The assessee is not an owner of the domestic satellite and nor is it operating the satellite. On the other hand, it is apparent that the assessee is claiming benefit/coverage under the said section on the basis that it is providing broadband/internet services etc. As long as it was providing the stipulated services and had received payments for the specified services, the income earned would

qualify for deduction under Section 80IA(4)(ii). In case the assessee incurs expenditure to buy and utilize space segment on a satellite for providing the qualifying services, the expenditure incurred cannot be disallowed and no notional income can be computed or reduced from the income earned/derived from the qualifying service. In view of the said position and in the absence of details, we have no option, but to remit the matter to the tribunal to examine the said aspect afresh. The tribunal has to examine and clearly decide nature and character of service rendered by the assessee to third parties and whether the same qualifies and is a prescribed/stipulated service under section 80IA. The order of remit is also necessary in view of the ambiguous stand of the assessee before the Assessing Officer and the appellate authorities which has contributed to the confusion. The letter written by the assessee to the Assessing Officer reads:-

> "From the above, it is clear that though the payment to BT is made in USD, yet the same was paid for use of domestic Satellite which is owned and operated by Department of Space, Government of India but leased out by Department of Space (DOS) to INTELSAT, who in-turn have subleased part of it to BT and some of which is used by the assessee Company. Hence, this is no question of disallowance under Section 80IA in this regard."

10. The question raised in ITA 284/2011 again requires an order or remit. The Assessing Officer noticed that the assessee had shown sales of Rs.2,12,28,512/-. On scrutiny of details, it was noticed that major sales were in respect of Antenna, RFT and other miscellaneous items, which included computer printer, UPS, CTV, air conditioner, hand camera, generator sets, telephone instruments, video conferencing systems, monitor etc. He held that the said equipments could be bought and procured from the Original Equipment Manufacturers (OEMS, for short) including the foreign vendors. Accordingly, Rs.50,42,717/- was excluded from the deduction claimed under Section 80IA of the Act as income not derived from specified services, after noticing that the cost of material was Rs.1,61,85,795/-. The CIT (Appeals) upheld the said addition holding that this was income derived from trading in goods. The tribunal has deleted the said addition, inter alia, holding :-

> "11. Let us have a look on the nature of equipments. We have perused pages number 29-40 of the paper book. On page 29-31 the copy of the import license for import of C band redundant 1:1 Up Converter and Down Converter have been placed on record. These are the technical device. Similarly on page 32-33 are the import license on page 34 is the description of the items which are to be imported. At page 34 the description of the items is Codan 40 Wku Band BUC. According to the assessee these equipments are essential equipments for enabling, assessee to the telecommunication services. The Govt. has put up various restrictions on import of

> such items because of security reasons. If the assessee is unable to provide these items to its customer then it might not be possible for it to provide telecommunication services. It was pointed out at the time of hearing that these equipments cannot be used for availing the services from any other service provider. The customer has to avail the telecommunication services through these items necessarily from the assessee only. Considering the nature of equipments and their relation to the nature of services provided by the assessee, in our opinion the receipt received by the assessee for supply of these items is inextricably links to the business of its telecommunication services. The AO is not justified in excluding these receipts. Therefore we direct the AO to include the receipt of Rs.5042717/- representing income from sale of equipment in the eligible receipt for grant of deduction u/s 80IA."

11. Learned counsel for the Revenue, during the course of hearing before us, has drawn our attention to the assessment order and the stand taken by the assessee. It was submitted that the assessee had stated and accepted that the customers could buy the equipment from them or from third parties and had pleaded that entire income, which was inextricably related to business of telecommunication and was exempt. Sale of equipment etc., had close and direct nexus with profit and gains of the stipulated industrial undertaking.

12. The legal contention of assessee is substantially correct. However, what was relevant and required examination was the contracts under which the sales were made. Sale of TV Camera, Air Conditioner, generator sets *per se* or on standalone basis

would not qualify for deduction 80IA read with sub-section (4) clause (ii). On the other hand, in case the assessee has been awarded a contract for providing telecommunication service, network of trunking and broadband/internet services and while and for executing the said contract, generator sets, air conditioner etc. were sold as a part of a complete package, then the income earned may qualify for deduction under Section 80IA. Therefore, each contract and nature thereof has to be examined. It has to be ascertained whether it was a case of supply of goods or it was a case where the assessee was providing qualifying services which mandated and required inextricably or as an necessary requirement, (under the same contract or under a different contract), sale/supply goods to operationalize and use/provide the telecommunication services. In case, the sale of goods was inextricably linked, had nexus and was connected with the primary purpose of providing or starting telecommunication services, the assessee will be entitled to benefit under Section 80IA. Otherwise, the assessee will not be entitled to exemption under Section 80IA on the transaction. Whether the commodities/goods could have been also purchased from a third party may not relevant and the determinative factor in many a case. It is the predominant or

primary reason or purpose why the contract was entered into, and whether it has direct nexus and is inextricably linked with providing the qualifying activities, is and would be the determinative factor. The substantial question of law is accordingly answered. An order of remit is passed, with a direction to the tribunal to decide the issue/question afresh in the light of the above observation/ratio.

13. The question No.1 raised in the appeal of assessee i.e. ITA 130/2011 relates to income earned from development and sale of software and whether the said amount qualifies for deduction under Section 80IA. The tribunal has not treated the proceeds from sale of software declared by the assessee as eligible for deduction under Section 80IA on the ground that the income derived from the sale of software was not derived from qualifying business i.e. telecommunication services. It has been observed that development of software was a separate source of business income. Accordingly, the total receipt of Rs.61,58,000/- from the sale of software should be excluded from the deduction claimed under Section 80IA of the Act.

14. The contention of the assessee, which is recorded in the order passed by the tribunal, is that the software developed was for upgrading the Network Management System (NMS, for

short), to enable smooth working of VSAT service under the technology from Via Sat and HSN at the request and on confirmed purchase orders from TVC India Pvt. Ltd. The justification given by the assessee to treat and regard the said income as eligible for deduction under Section 80IA, reads as under:-

> "……The Hub controls the entire operations of the communication network through a NMS, which continuously accumulates data on the system so as to provide regular 'health checks' for the remotes and determine the level of activity for billing purpose. The NMS, which is principally a software, is an integral part of Hub station for running VSAT services at various remotes. The NMS needs to be regularly updated and maintained for a smooth and trouble free service. Since TVC could not have the upgrades of these NMS's through the OEMs, the appellant provided the upgrades so that a smooth and uninterrupted service on the VSATs located at various remotes could be provided, it was argued that the software developed by the appellant is a part of the satellite based telecommunication services rendered by it. The appellant had the requisite expertise for the software development. The appellant under the impugned software developed four modules for TVC. Each module was developed to provide wide time window for packet transfers between TVC and Bank of Tokyo & Mitsubishi, Ludhiana Stock Exchange, EIH and BNP respectively. Without this software, the client of the appellant (TVC) could not have satellite connection with the abovementioned companies and the signal could not be transmitted thereto. The sole motive of developing the software was to further its telecommunication operations and was thus, inextricably linked to the business of the appellant of providing telecommunication services."

15. We find that the tribunal has not examined the said aspect and question with reference to the contention raised by the assessee, on the nature and character of the software, which was developed and sold. The exact reasoning given by the tribunal reads as under:-

> "4.8 In regard to income from software, the development of software is certainly a separate source of business income of the appellant different from providing Telecommunication services. Thus, this income cannot be said to the income derived from the eligible business of providing Telecommunication service. The appellant has shown total receipts of Rs.61,58,000/- from development and selling of software. The A.O. has allowed expenses on account of salary paid to employees and other administrative expenses of Rs.4,00,000/- and calculated the net profit from software development at Rs.57,58,000/-. The A.R. of the appellant submitted that the appellant had incurred higher amount of expenses than Rs.4,00,000/- on the development of software because apart from personnel/staff, the appellant had incurred various other overhead charges also. But the appellant had not furnished any details of expenses in excess of 4,00,000 incurred for the development of software. In these circumstances, the calculation made by the A.O. does not warrant any interference. Since the income earned from development of software was not profit and gains derived from the eligible business of providing Telecommunication service, the A.O. was justified in excluding the income from software development for computing deduction u/s 80IA."

16. We find that the Assessing Officer as well as the appellate authorities have not examined the issue/question keeping in mind the mandate of the section and contention of the assessee. Nature, character and type of the software and whether or not it

could be treated and regarded as income earned from the business referred to in sub-section (4) clause (ii) to Section 80IA has not been examined and considered. Without examining the said aspect and the factual position regarding nature and type of software, the Assessing Officer and the appellate authorities were not justified in excluding the sale proceeds from computation of deduction under Section 80IA. The Assessing Officer has merely recorded that the assessee had furnished copy of the work orders as well as the bill raised and in view of the judicial pronouncements, income from selling of software cannot be considered as income earned or derived from the activities specified in Section 80IA(4)(ii) of the Act. This issue is accordingly remitted to the tribunal for a fresh decision. The tribunal will examine the nature, type and character of the software or whether it was inextricably and directly connected with the activities/services stipulated in clause (ii) to sub-section (4) of Section 80IA. This is a technical aspect and if required, the tribunal can take help and/or opinion of experts. The assessee will be also at liberty to justify and establish their claim by filing opinion from the experts. Question No.1 is accordingly answered with an order of remit.

17. The last question is question No.2 in ITA No.130/2011.

The findings recorded by the tribunal in this regard are that the assessee had earned interest income on FDRs of Rs.7,61,584/- and other interest of Rs.77,042/-. It has been observed by the tribunal that the aforesaid receipts cannot be included in the income derived from the specified activities in view of the decision of this Court in ***CIT Vs. Shri Ram Honda Power Equip*** (2007) 289 ITR 475.

18. The assessee has submitted that they had earned this interest of Rs.8,38,626/- on FDRs pledged with the banks for availing non- fund based credit limits but they had paid interest of Rs.1,70,99,277/- and, effectively the net interest paid was the expense. Interest earned was business income directly connected with the qualifying service and therefore should be set off from the interest paid. It was stated that the interest earned had direct nexus with the business of the assessee since the FDRs were pledged as margin money for availing credit limits. The Assessing Officer, however, did not agree with the said contention. The CIT (Appeals) agreed with assessee and held that the interest on deposit was taxable as “business income” and not under the head “income from other sources” and therefore the assessee was entitled to deduction under Section 80IA(4)(ii). As noticed above, the tribunal has reversed

the findings of the CIT(Appeals) and agreed with the Assessing Officer.

19. Decision of this Court in ***Shri Ram Honda*** *(supra)* consists of two parts. In the first part it has been held that interest income is not income derived from exports as it is not a part of export proceeds and is not a direct and proximate result of exports earning but earning made from deposit of money and payment by the bank. The second part of the said judgment deals with computation under Explanation (bba) to Section 80HHC. For the purpose of the said explanation, it has been held that interest refers to and means net interest and not gross interest, provided the interest earned is taxable under the head "income from business" and not under the head "income from other sources." This view has been upheld by the Supreme Court in its recent decision in ***ACG Associated Capsules Private Limited. Vs. Commissioner of Income Tax*** (2012) 3 SCC 321. The Supreme Court approving the said judgment has referred to their earlier Constitution Bench's decision in ***Distributors (Baroda) (P) Ltd. Vs. Union of India*** (1986) 1 SCC 43 and observed as under:-

> "11. Before we deal with the contentions of Learned Counsel for the parties, we may extract Explanation (baa) to Section 80HHC of the Act.

Explanation: For the purposes of this section,-

* * *

(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-

1300 ninety per cent of any sum referred to in clauses (iiia), (iiib), (iiic), (iiid) and (iiie) of Section 28 or of any receipts by way of brokerage, commission, interest, rent, charges or any other receipt of a similar nature included in such profits; and

(2) the profits of any branch, office, warehouse or any other establishment of the Assessee situate outside India.

12. Explanation (baa) extracted above states that "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 the receipts of the nature mentioned in Clauses (1) and (2) of the Explanation (baa). Thus, profits of the business of an Assessee will have to be first computed under the head "Profits and Gains of Business or Profession" in accordance with provisions of Sections 28 to 44D of the Act. In the computation of such profits of business, all receipts of income which are chargeable as profits and gains of business under Section 28 of the Act will have to be included. Similarly, in computation of such profits of business, different expenses which are allowable under Sections 30 to 44D have to be allowed as expenses. After including such receipts of income and after deducting such expenses, the total of the net receipts are profits of the business of the Assessee computed under the head "Profits and Gains of Business or Profession" from which deductions are to made under Clauses (1) and (2) of Explanation (baa).

13. x x x x x x x

14. x x x x x x x

15. Section 80M of the Act provided for deduction in respect of certain intercorporate dividends and it provided in Sub-section (1) of Section 80M that "where the gross total income of an

> Assessee being a company includes any income by way of dividends received by it from a domestic company, 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 from such income by way of dividends an amount equal to" a certain percentage of the income mentioned in this Section. The Constitution Bench held that the Court must construe Section 80M on its own language and arrive at its true interpretation according to the plain natural meaning of the words used by the legislature and so construed the words "such income by way of dividends" in Sub-section (1) of Section 80M must be referable not only to the category of income included in the gross total income but also to the quantum of the income so included.
>
> 16. Similarly, Explanation (baa) has to be construed on its own language and as per the plain natural meaning of the words used in Explanation (baa), the words "receipts by way of brokerage, commission, interest, rent, charges or any other receipt of a similar nature included in such profits" will not only refer to the nature of receipts but also to the quantum of receipts included in the profits of the business as computed under the head "Profits and Gains of Business or Profession" referred to in the first part of the Explanation (baa). Accordingly, if any quantum of any receipt of the nature mentioned in Clause (1) of Explanation (baa) has not been included in the profits of business of an Assessee as computed under the head "Profits and Gains of Business or Profession", ninety per cent of such quantum of the receipt cannot be deducted under Explanation (baa) to Section 80HHC."

20. The Supreme Court in ***ACG Associated Capsules*** (supra), did not approve the view of the Bombay High Court in ***CIT Vs. Asian Star Company Ltd.***(2010) 326 ITR 56 (Bom.).

21. We have quoted Section 80IA (1) and (2A) above. For determining the income derived by an undertaking or enterprise, we have to compute the total income of the assessee from the

business referred in sub-section (4) to Section 80IA. The words used in Section 80IA(1) and (2A) are "profit and gains of eligible business". On the basis of same logic and reasoning, we have to first find out the profit and gains of business from the specified activities. Section 80IA was interpreted and elucidated in ***Liberty India v. Commissioner of Income Tax,*** *(2009) 9 SCC 328*.It was highlighted Section 80IA is a profit linked incentive and only profits "derived from" eligible business are entitled to deduction. The expression "derived from" covers sources not beyond the first degree. Devices to inflate or reduce profits from eligible business should be rejected. On DEPB utilization and duty drawback it was held:-

> **"39.** Analysing the concept of remission of duty drawback and DEPB, we are satisfied that the remission of duty is on account of the statutory/policy provisions in the Customs Act/Scheme(s) framed by the Government of India. In the circumstances, we hold that profits derived by way of such incentives do not fall within the expression "profits derived from industrial undertaking" in Section 80-IB."

22. Reliance was placed by the assessee on AS 2 and explaining the same in Liberty India (supra), it was held;-

> **"40.** Since reliance was placed on behalf of the assessee(s) on AS-2 we need to analyse the said standard. AS-2 deals with valuation of inventories. Inventories are assets held for sale in the course of business; in the production for such sale or in the form of materials or supplies to be consumed in the production. "Inventory" should be valued at the lower of cost and net realisable value (NRV). The cost of "inventory" should comprise all costs of purchase, costs of conversion and other costs including costs incurred in

bringing the "inventory" to their present location and condition.

41. The cost of purchase includes duties and taxes (*other than those subsequently recoverable by the enterprise from taxing authorities*), freight inwards and other expenditure directly attributable to the acquisition. Hence trade discounts, rebate, duty drawback, and such similar items are *deducted* in determining *the costs of purchase. Therefore, duty drawback, rebate, etc. should not be treated as adjustment (credited) to cost of purchase* or manufacture of goods. They should be treated as separate items of revenue or income and accounted for accordingly (see p. 44 of *Indian Accounting Standards & GAAP* by Dolphy D'Souza).

42. Therefore, for the purposes of AS-2, CENVAT credits should *not* be included in the cost of purchase of inventories. Even the Institute of Chartered Accountants of India (ICAI) has issued Guidance Note on Accounting Treatment for CENVAT/MODVAT under which the inputs consumed and the inventory of inputs should be valued on the basis of purchase cost *net* of specified duty on inputs (i.e. duty recoverable from the Department at a later stage) arising on account of rebates, duty drawback, DEPB benefit, etc. Profit generation could be on account of cost cutting, cost rationalisation, business restructuring, tax planning on sundry balances being written back, liquidation of current assets, etc.

43. Therefore, we are of the view that duty drawback, DEPB benefits, rebates, etc. cannot be credited against the cost of manufacture of goods debited in the profit and loss account for purposes of Sections 80-IA/80-IB as such remissions (credits) would constitute independent source of income beyond the first degree nexus between profits and the industrial undertaking.

44. We are of the view that the Department has correctly applied AS-2 as could be seen from the following illustration:

Expenditure	*Amount*(Rs)	*Income*	*Amount*(Rs)
Opening stock	100	Sales	1000
Purchases (including customs duty paid)	500	Duty drawback received	100
Manufacturing overheads	300	Closing stock	200
Administrative, selling and distribution expenses	200		
Net profit	200		
	1300		1300

Note: *In the above example, the Department is allowing deduction on profit of Rs 100 under Section 80-IB of the 1961 Act*."

(emphasis supplied)

23. In view of the aforesaid observations in the case of Liberty India (supra), the aforesaid second question of law in ITA No. 130/2011 is answered in negative with an order of remand to the tribunal. In the absence of details, it is directed that the tribunal will examine the factual matrix of the present case including the balance-sheet and accounts of the assessee, to decide the question. It will be open to the tribunal to examine and consider the contention of the assessee, if raised and supported by facts, the quantum of expenditure incurred/attributed to earning of exempt income under Section 80IA of the Act.

24. The appeal is accordingly disposed of. There will be no order as to costs.

-sd-
(SANJIV KHANNA)
JUDGE

-sd-
(R.V. EASWAR)
JUDGE

May 17th, 2012
NA