

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATE : 22.04.2015

CORAM

**THE HONOURABLE MR. JUSTICE R.SUDHAKAR
AND
THE HONOURABLE MS. JUSTICE K.B.K.VASUKI**

T.C.A. NOS. 1441 & 1442 OF 2007

Commissioner of Income Tax
Chennai.

.. Appellant in both the appeals

- Vs -

Funskool (I) Ltd.
826, 6th Floor, Tarapore Towers
Anna Salai, Chennai - 2.

.. Respondent in both the appeals

Appeals filed against the order dated 19.01.07 passed by the Income Tax Appellate Tribunal, Madras 'A' Bench, Chennai, made in ITA Nos.183/Mds/2005 and 1232/Mds/2006.

For Appellant : Mr. T.R.Senthil Kumar

For Respondent : Mr. Venkatnarayanan for
M/s.Subbaraya Aiyar Padmanabhan

COMMON JUDGMENT

(DELIVERED BY R.SUDHAKAR, J.)

Aggrieved by the order of the Tribunal in allowing the appeal filed by the assessee for the assessment year 2001-2002 and dismissing the appeal filed by the Revenue for the assessment year 2002-2003, the Revenue is before this Court by filing the present appeals. This Court, vide order dated

19.11.07, while admitting the appeals, framed the following substantial question of law for consideration :-

"Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that the stickering income received from MRF for labeling 'MRF' on the toys and packing, as eligible business income for the purpose of deduction under Section 80HHC of the Act?"

2. The brief facts of the case are as follows :-

The respondent/assessee in these cases is engaged in the business of exporting toys. The process of manufacture of the toys involves manufacture and then stickering job is performed, which involves three activities. The first activity involves "Tampoo Printing" with a power driven machine on the tyres and the letters "MRF" are imprinted in white colour. The second activity involves printing of "MRF" letters in various forms/designs on the boxes of the toys and the last activity is purchasing the stickers with the letters "MRF" and pasting the same on the boxes that contain the toys. In regard to the said activities, for the assessment years 2001-2002 and 2002-2003, the assessee claimed deduction under Section 80HHC on the income received for stickering the label 'MRF' on the toys. The assessing officer excluded the stickering income from business profits by invoking Explanation (baa) to Section 80HHC of the Income Tax Act. Aggrieved by the said order of the Assessing Officer, the assessee preferred appeals to the CIT (Appeals).

3. The CIT (Appeals), for the assessment year 2001-2002, while negated the contention of the assessee and upheld the order of the Assessing Officer, however, for the subsequent assessment year 2002-2003, allowed the appeal on the ground that stickering charges arise out of manufacturing activity and forms part of the business profits for the purpose of deduction under Section 80HHC.

4. Aggrieved by the said orders, before the Tribunal, while the assessee preferred appeal in respect of the assessment year 2001-2002, the Revenue filed appeal in respect of the assessment year 2002-2003. Before the Tribunal, physical demonstration was made by the assessee showing the toys with stickers as also without stickers and it was submitted by the assessee that the activities are done with the help of various machines involving manpower of the company; that by putting these stickers, the value of the toy is enhanced and as a result it becomes part of the operational income and, therefore, it is eligible for deduction under Section 80HHC. To substantiate their argument, various case laws were cited by the assessee. On the contrary, the stand of the Department before the Tribunal was that stickering on the tyres and toys is of no consequence as the customer is not bothered about what is the nature of the sticker. It was the further stand of the Department that the assessee was receiving this income as advertisement and, therefore, not eligible for the benefit as

claimed by them. It was further contended on behalf of the Department that putting the stickers does not involve any element of turnover and, therefore, not entitled for deduction under Section 80HHC. However, on consideration of the entire gamut of facts as also the the case laws relied on by the parties, the Tribunal found that the decision of Bombay High Court in ***CIT - Vs - Bangalore Clothing Co. (260 ITR371 (Bom.))*** was applicable, and accordingly, following the same, held that the activity carried on by the assessee is an operational activity. For better clarity, the relevant portion of the order of the Tribunal is extracted hereinbelow :-

"5. We have considered the rival submissions carefully and have gone through the relevant material on record as well as the decisions cited by the parties. From the photographs and physical demonstration of toys, it becomes clear that the assessee's manufacturing apparatus was used for the purpose of stickering activity. We are of the opinion that it is very difficult to say that stickers put on various parts of toys like tyres, will not enhance the value of the toy, because by putting such stickers, they become more attractive. In the process, if the assessee has received some money, then same is definitely part of the turnover also. In CIT v. Bangalore Clothing Co. (260 ITR 371 (Bom.)), it was clearly held by the Hon'ble Bombay High Court that if the particular activity is operational activity, then same is entitled for deduction u/s 80HHC. Here, in the case before us, the assessee has made various operations for putting stickers on the toys. Various Benches of the Tribunal have also taken the view that if the manufacturing apparatus is used for carrying out some activity, then such activity is an operational activity. Even in the decision of K.R.M. Marine Exports Ltd. v. ACIT (201 CTR

(Mad.) 1), relied on by the Id. DR, it is clearly observed in paragraph 20 that if an activity is done with the help of industrial undertaking of the assessee, then same is an operational activity. Therefore, we are of the view that stickering activity is operational activity of the assessee and is entitled to deduction u/s 80HHC."

Aggrieved by the abovesaid order of the Tribunal, the Revenue is before this Court by filing the present appeals on the above substantial question of law.

5. Learned standing counsel appearing for the Department reiterated the submissions as made before the Tribunal to sustain the case and submitted that the activity undertaken by the respondent/assessee cannot be treated as business income for the purpose of deduction under Section 80HHC. It is the further submission of the learned standing counsel for the appellant that the stickering income is in the nature of receipts as mentioned in Explanation (baa) to Section 80HHC and, therefore, has to be excluded from business income for the purpose of deduction under Section 80HHC. It is the further submission of the learned standing counsel for the appellant that the income has to be construed more in the nature of advertisement charges received by the assessee and, therefore, the said receipts have to be excluded in terms of Explanation (baa) to Section 80HHC of the Act.

6. Per contra, learned counsel appearing for the respondent submitted

that the Tribunal, on consideration of the entire facts and on appreciation of the decisions placed before it, has come to the just conclusion by following the decision of the Bombay High Court in *Bangalore Clothing Co. case (supra)* and, therefore, no interference is warranted with the well considered findings of the Tribunal.

7. Heard the learned standing counsel appearing for the appellant and the learned counsel appearing for the respondent and perused the materials available in the typed set of documents and also the decisions on which reliance has been placed by the Tribunal in arriving at its finding.

8. Before proceeding to analyse the case on hand, it would be useful to refer to Explanation (baa) to Section 80HHC of the Act, on which much stress has been placed by the learned standing counsel appearing for the appellant. For better clarity, Explanation (baa) to Section 80HHC of the Act is extracted hereinbelow :-

"80HHC.

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 ---

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

and

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

9. For better appreciation of the matter, it would also be useful to refer to the decision of the Bombay High Court in *Bangalore Clothing Co. case (supra)*, on which reliance has been placed by the Tribunal for arriving at its finding. The relevant portion of the judgment is extracted hereinbelow for better clarity :-

"..... Explanation (baa) was introduced into the Act by the Finance (No. 2) Act, 1991, with effect from April 1, 1992. Under the Circular of the Central Board of Direct Taxes bearing No. 621, dated December 19, 1991 (see [1992] 195 ITR (St.) 154), it has been stated that the above formula gave a distorted figure of export profits when receipts like interest, commission, etc., which do not have an element of turnover are included by the assessee in the profit and loss account. Therefore, Explanation (baa) came to be introduced. Under that Explanation profits of the business, for the purposes of section 80HHC, does not include receipts which do not have an element of turnover like rent, commission, interest, etc. However, as some expenditure might be incurred in earning such incomes an ad hoc 10 per cent deduction from such incomes is provided to account for those expenses. However, learned counsel for the Department cannot invoke Explanation (baa) in every matter involving receipts by way of brokerage, commission, interest, rent, labour charges, etc. These items of income have got to be seen in the context of the business activity of the assessee. To give an example, in the case of a manufacturing company which undertakes

exports, receipt of interest or commission may not be operational income because they do not have the element of turnover and consequently Explanation (baa) will apply. However, that will not be the case if the assessee is carrying on the business of financing because in the case of financing, the interest income which accrues to the assessee will have the element of turnover and in such a case, receipts like interest, will not attract Explanation (baa). The point which we would like to make, therefore, is that in every matter the Assessing Officer will have to ascertain whether receipt of interest, commission, labour charges, etc., were a part of operational income. We cannot lay down any standard test for deciding what would constitute operational income. Broadly, the Department will have to consider the memorandum and articles of association of the company, the nature of the business, the nature of the activity and such other tests. The Department will also have to ascertain as to what is the dominant business of the company and whether receipts like interest, commission, etc., accrue as a part of the main business activity or whether they accrue out of incidental business."

10. Explanation (baa) to Section 80HHC of the Income Tax Act postulates that "profits of business" means the profits of the business as computed under the head "Profits and gains of business or profession" specified under Section 28 to 44D of the Income Tax Act. The amount so computed should be reduced by 90% of the incentive income 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

similar nature included in such profits and the profits of any branch, office, warehouse or any other establishment of the assessee situate outside India. The Tribunal, on facts, has found that the activity involved in the case requires use of machinery, labour and material which were also forming part of the activity of manufacturing of toys for exports. This is a finding of fact. It has not been challenged in the memo of appeal. The memo of appeal proceeds only on the basis that since the receipt is for the purpose of labelling 'MRF' on the toys, the charges received by the assessee would fall under the head advertisement charges and, therefore, Explanation (baa) stood attracted. It is trite law that each case has to be decided on its own facts. Therefore, each case will have to be examined by the Assessing Officer as to whether receipt of income is a part of operational income and whether the element of turnover exists. In the case on hand, it is evident from the records that the nature of activity carried on by the respondent/assessee and the receipts realised therefrom by the assessee/respondent does not fall under any of the heads mentioned in Explanation (baa) to Section 80HHC and, therefore, the provisions of Explanation (baa) to Section 80HHC does not stand attracted to the receipts received by the respondent/assessee. The decision of the Bombay High Court in *Bangalore Clothing Co. case (supra)*, relied on by the Tribunal is squarely applicable to the facts of the present case.

11. Further, the decision in ***K.R.M. Marine Exports Ltd. - Vs - ACIT***

(201 CTR 1 (Mad)), on which reliance was placed by the Department, the Tribunal held that in para-20 of the said decision, it has been categorically held that operational activity is one of the parameters for grant of benefit under Section 80HHC. In the case on hand, the activity of the assessee in carrying out labelling 'MRF' on toys using its machinery would squarely fall within the ambit of operational activity.

12. For the reasons aforesaid, this Court is in complete agreement with the findings of the Tribunal and is of the considered view that no interference is called for with the well considered order passed by the Tribunal. Accordingly, the ***substantial question of law is answered in favour of the assessee/respondent and against the appellant/Revenue.***

13. In the result, these appeals filed by the appellant/Revenue are dismissed. However, in the circumstances of the case, there shall be no order as to costs.

(R.S.J.) (K.B.K.V.J.)

22.04.2015

Index : Yes/No

Internet : Yes/No

GLN

To

1. Commissioner of Income Tax
Chennai.
2. The Income Tax Appellate Tribunal
Madras 'A' Bench, Chennai.

R.SUDHAKAR, J.
AND
K.B.K.VASUKI, J.

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