

IN THE HIGH COURT OF KERALA AT ERNAKULAM

PRESENT :

THE HONOURABLE MR. JUSTICE C.N.RAMACHANDRAN NAIR
&

THE HONOURABLE MR. JUSTICE T.R.RAMACHANDRAN NAIR

MONDAY, THE 3RD MARCH 2008 / 13TH PHALGUNA 1929

ITR.No. 64 of 2000()

AGAINST THE ORDER DATED / / IN RA.136/COCH//1998
IN ITA.38/COCH/97 of I.T.A.TRIBUNAL,COCHIN BENCH
.....

APPLICANT:

M/S.WILLIAM GOODACRE & SONS
INDIA LTD., ALLEPPEY.

BY ADV. SRI.B.S.KRISHNAN (SR.)
SRI.K.ANAND (A.201)

RESPONDENTS:

THE COMMISSIONER OF INCOME TAX,
TRIVANDRUM.

BY ADV. SRI.P.K.R.MENON(SR.),SR.COUNSEL FOR IT
SRI.GEORGE K. GEORGE, SC FOR IT

THIS TAX REFERENCE HAVING BEEN FINALLY HEARD
ON 03/03/2008, ALONG WITH ITR NOS.65&79/2000 & ITA
NO.210 OF 2002, THE COURT ON 03/03/2008 DELIVERED THE
FOLLOWING:

C.N.RAMACHANDRAN NAIR &
T.R.RAMACHANDRAN NAIR, JJ.

.....
I.T. Reference Nos.64, 65 & 79 of 2000 &
I.T. Appeal No.210 of 2002
.....

Dated this the 3rd day of March, 2008.

JUDGMENT

C.N.Ramachandran Nair, J.

These connected tax reference cases and appeal arise from orders of the Income Tax Appellate Tribunal confirming exclusion of 90% of income of various nature from the total profits of the assessee in the computation of export profit under Section 80HHC of the Income Tax Act. Besides manufacturing and exporting of products, the assessee was engaged in doing job works for others, particularly exporters, the income wherefrom was also included as business profit in the computation of proportionate export profit for deduction under Section 80HHC of the Act. The receipts involved are:

1. Income received for job works.
2. Latex backing charges received and
3. Rubber edging charges received.

Senior counsel appearing for the assessee clarified and the orders describe the nature of activities done by the assessee as the processing of items

supplied by the awarders into final product in their factory by giving rubber latex backing to door mats and other coir products and giving rubber edging to the door mats, carpet etc. made of coir. The Assessing Officer along with some other items excluded 90% of the above items of receipt from profit in the computation of export profit by referring to clause (baa) of Explanation to Section 80HHC (4B) of the Income Tax Act. The assessee's contention is that exclusion of 90% from profits of business can be made only if the charges received and accounted by the assessee are in the form of income partaking the character of brokerage, commission, interest or rent as referred to in sub-clause(1) under item (1) of clause (baa) contained in the Explanation to the abovereferred provision. According to the assessee, the charges received are manufacturing charges and charges received thereon form part of the total turnover and so much so, there is no scope for exclusion under the above provision. Senior Standing Counsel appearing for the department on the other hand contended that the receipts accounted by the assessee squarely falls within the "charges" and so much so, exclusion of 90% of the same was rightly made in the computation of eligible export profit for deduction. In order to appreciate the contentions raised, we have to refer to the relevant provisions of the Act and for this

purpose we extract the relevant provision hereunder:

Explanation to S.80HHC (4B):-

"

(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 percent of any sum referred to in clauses (iiia), (iiib) and (iiic) of section 28 or of any receipts by way of brokerage, commission, interest, rent, charges or any other receipt of a similar nature included in such profits; and

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

....."

Counsel for the assessee relied on several decisions of High Courts, particularly of the Karnataka High Court in COMMISSIONER OF INCOME TAX V. BANGALORE CLOTHING COMPANY (2003) 260 ITR 371, that of the Madras High Court in COMMISSIONER OF INCOME TAX V. KIRAN PROCESSORS (2007) 288 ITR 165 and that of Kerala High Court in COMMISSIONER OF INCOME TAX V. UNITED MARINE EXPORTS (2005) 278 ITR 155 and contended that the charges received are comparable to the receipts held as allowed by the High Courts

in the decisions reported. Senior counsel for the Revenue relied on the decisions followed by the Tribunal and also the decision of the Supreme Court in COMMISSIONER OF INCOME TAX V. LAKSHMI MACHINE WORKS (2007) 290 ITR 667 wherein they relied on general principles laid down by the Supreme Court for interpretation of the Section.

2. There can be no doubt about the scheme of Section 80HHC of the Act which provides for computation of export profit of an assessee engaged in local business and export business based on the formula provided in the Section to find out proportionate profit on export with reference to total turnover and total profit. Under the formula, eligible export profit is the total profit divided by total turnover and multiplied by export turnover. The scheme of exclusion of certain items of income which come within the description of business profits by virtue of inclusion clause contained in Section 28 of the Act, is to ensure that in the course of working out the eligible export profit on a proportionate basis with reference to the total turnover and export turnover, the net result should not be a distorted figure. In other words, the formula seeks to achieve determination of export profit as realistic and as near as possible. The purpose of clause (baa) is to exclude such items of receipts which are not derived from business

turnover. Brokerage, commission, interest and rent etc. are obviously items which are essentially in the nature of net receipts and are not derived out of the total turnover of the assessee. In fact besides these four items enumerated in clause (baa)(1), charges or any other receipt of a similar nature should also be excluded. Even though Senior Counsel appearing for the Revenue submitted that charges referred to under the sub-section are independent of other items referred therein, we are unable to accept this proposition because "charges" along with any other receipt referred to in the above clause are the residuary items of income which qualify for inclusion under (baa) only if such receipt is in the nature of brokerage, commission, interest or rent. In other words, if the charges are not comparable to any of these items, then such items cannot be excluded from business profit in terms of clause (baa) of the Explanation referred to above. Senior counsel appearing for the assessee contended that raw material for rubber backing and rubber edging namely, rubber latex is purchased by the assessee at their own cost and used it in the job work and therefore, entire receipt is turnover of the business. If the assessee's contention is factually correct, we feel the claim is quite tenable in as much as the rubber backing charges and rubber edging charges cannot be excluded from total profit by referring to clause

(baa) of the impugned Section. On the other hand if raw materials are supplied by the awarder, or if the assessee purchased the raw materials separately in their name and claimed separate reimbursement of the same, then of course the turnover of the transaction does not get included in the total turnover and the receipt is net receipt 90% of which has to be excluded as "charges" under clause (baa). Strangely, none of the authorities considered the claim of the assessee that they were purchasing raw materials in their own account and used them in manufacture of final product leading to value addition at the assessee's cost on the awarder's raw material like door mats and coir carpets. In fact a single document namely, sales tax assessment for the relevant year would have proved this fact in as much as if the assessee has purchased rubber latex in their own account and used it in the embellishment work on the product of the awarder, then assessee would have incurred sales tax leading to liability for sales tax on purchase of raw material namely, rubber and sales tax on works contract. However, the assessee's contention based on the decisions abovereferred that even if raw material is supplied by the awarder or purchased by the assessee on reimbursement basis, without its value forming part of total turnover, the assessee is still entitled to inclusion of the

above items in the total profit is unacceptable because the activity referred to in the decisions are not one comparable to what is carried on by the assessee which is just job work leading to value addition of the product where the substantial portion of value addition is attributable to raw material cost. In other words, unless raw material cost is borne by the assessee in their own account forming its sale value also as total turnover, the assessee cannot claim the benefit of inclusion of full charges so collected in the total profit. In other words if the entire raw material costs are borne by the awarder and if the assessee does only job work, though with machinery and employing their labour, such charges are certainly comparable to commission or brokerage which also are income earned by incurring labour and other charges by the assessee covered by clause (baa). Since the facts are not on record, we set aside the orders of the Tribunal and of all authorities below on this issue and remand the matter to the Assessing Officer to call for details, sales tax assessments for the relevant years etc. from the assessee and find out whether the transaction really represents investment by the assessee in raw material, labour etc. and if the Assessing Officer finds that assessee has borne cost of raw material and engaged in improvement or value addition of the raw materials and the total turnover

includes cost of raw material, labour charges and profit and sales tax, then the Officer is directed to include the entire receipts in total profit i.e. without exclusion under clause (baa) of the Act. The Assessing Officer is directed to find out the eligible profit in terms of the above direction and issue fresh orders after giving an opportunity to the assessee, within a period of three months from the date of receipt of copy of this judgment. The Reference Cases as well as the Appeal are disposed of as above.

A copy of this judgment under the seal of the High Court and signature of the Registrar shall be forwarded to the Income Tax Appellate Tribunal, Cochin Bench.

C.N.RAMACHANDRAN NAIR
Judge

T.R.RAMACHANDRAN NAIR
Judge

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