IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 5475 OF 2008
(Arising out of SLP(C) No. 7323 of 2007)

M/s. Mysodet (P) Ltd. .... Appellant

Versus

Commissioner of Income Tax, Bangalore .... Respondent

O R D E R

1. Leave granted.

2. This Civil Appeal is directed against the judgment and order dated 18th April, 2006 delivered by Karnataka High Court in I.T.R.C. No. 901 of 1998.

3. The assessee is a limited company. It purchased 105 computers for Rs.90,91,063/-. It exported them and realized export sales of Rs.90,91,063/-. There were no profits during that relevant Assessment Year on the export sales. The relevant Assessment Year is AY 1990-91. The I.T.O. allowed the claim of deduction under Section 80HHC at Rs.15,81,389/-. It may be noted that according to the calculations made by the I.T.O. the business income stood at Rs.55,31,941/- to which the I.T.O. applied the ratio in terms of Section 80HHC(3)(b). Applying that ratio the export profits worked out to Rs.15,81,389/-. The formula adopted was as follows :-

$$\text{Export Profits} = \frac{90,91,063}{3,18,01,941} \times 55,31,941$$

4. Aggrieved by the decision of the I.T.O. the Department went in revision. The Revisional Authority and the Tribunal accepted the contention advanced on behalf

of the Department. The revision was under Section 263 of the Income Tax Act. It was held that Section 80HHC (1) refers to profits derived from the export business and it is with reference to such profits that deduction under Section 80HHC is to be computed. According to the Commissioner Section 80HHC confers the benefit only on those assessees who have not only carried the export business but who have also derived profits from such business. According to the Commissioner Section 80HHC (3)(b) is a machinery provision which enables the AO to compute profits from export business particularly when the income of the assessee accrues from composite business of domestic and export sales. For the above reasons the order of the I.T.O. in favour of the assessee was set aside by the Commissioner against which the assessee carried the matter in appeal to the Tribunal. The Tribunal took the view that in view of the decision of I.T.A.T., Delhi Branch (Special Bench) in the case of International Research Park Laboratories Ltd. Vs. ACIT (212 ITR, Page 1) profits need not be earned in the export business alone to claim special deduction under Section 80HHC. Accordingly, in this case I.T.A.T. allowed the assessee's appeal and restored the order of the I.T.O. giving deduction to the assessee. Aggrieved by the decision of the I.T.A.T. the matter was carried by way of Reference under Section 256 (2) of 1961 Act to the Karnataka High Court which took the view that in view of the decision of the Supreme Court in IPCA Laboratory Ltd. Vs. Deputy Commissioner of Income-Tax reported in 266 ITR , Page 521 since the assessee had not earned profits from export sales during the year in question, the assessee was not entitled to deduction under Section 80HHC. Accordingly, the Department's appeal came to be allowed. Hence, this Civil Appeal by the assessee.

5. At the outset it may be stated that Section 80HHC falls under Chapter VI-A which refers to deductions to be made in computing total income. Under Section 80A it is

inter alia provided that in computing total income of an assessee, there shall be allowed from his gross total income deductions specified in Section 80C to 80U. It is further provided that the aggregate amount of deductions under Chapter VI-A shall not exceed the gross total income of the assessee. In our opinion, Section 80A governs Section 80HHC which deals with deductions in respect of profits retained for export business. At this stage we may also note that the head note to Section 80HHC refers to deduction in respect of profits retained <u>for</u> export business. It is not profits retained from export business. Moreover, prior to 1.4.86 Section 80HHC referred to deduction in respect of export turnover. That phraseology has been changed later on. We are concerned with the Assessment Year 1990-91. Keeping in view the above analysis we have to interpret Section 80HHC(3). At this stage it may be noted that eligibility for deduction is contemplated by Section 80HHC(1) whereas quantum of deduction is determined under Section 80HHC(3). In the matter of determining the quantum of deduction, the "principle of proportionality" applies. There are two situations which are covered by Section 80HHC(3), namely, turnover only from export sales and, secondly, turnover from composite sales (domestic and export business). In both cases the formula applies as under :-

$$\text{S. 80HHC concession} = \text{export profits} = \text{profits of business} \times \frac{\text{Export T.O.}}{\text{Total T.O.}}$$

In the first situation where the business of the assessee is only in terms of exports exclusively, the profits of business has to be multiplied by 1/1. However, when it comes to composite business the profits of business in the above formula has to multiplied by two different figures in the denominator and nominator. This calculation has been correctly done by the I.T.O. as indicated hereinabove. The I.T.O. took into account the business

income at Rs.55,31,941/- to which he correctly applies the ratio of Rs.90,91,063/Rs.3,81,01,941. In the case of composite business, as stated above, the figure of export turnover is quite different from total turnover. The entire object for applying the principle of proportionality is to derive export profits from total business profits. As stated above, this formula applies both under Section 80HHC(3)(a) as well as 80HHC(3)(b).

6. In the present case, it appears that the High Court has decided the matter against the assessee overruling the decision of the Tribunal by placing reliance on the judgment of this Court in IPCA Laboratory Ltd. (supra). In our view the High Court could not have relied upon the judgment of this Court in IPCA Laboratory Ltd. (supra) for two reasons. Firstly, Section 80HHC(3) has undergone amendments 11 times. We are concerned with the initial period when the above formula was simplistically stated. Later on that formula has undergone a change by several amendments. IPCA Laboratory Ltd. was concerned with the Assessment Year 1996-97. By that time the formula had undergone a change. By that time the concept of adjusted export turnover, adjusted profits of business and adjusted total turnover had come into play. Therefore, the High Court had erred in relying upon the judgment of this Court in IPCA Laboratory Ltd. (supra). Secondly, in the present case we are concerned with the Assessment Year 1990-91. At that time the above formula existed. On 5.7.1990 CBDT had issued a circular No. 564. We quote herein below paras 4, 6 and 9.

> **"4. Sub-section(3) of section 80HHC statutorily fixes the quantum of deduction on the basis of a proportion of the profits of business under the head "Profits and gains of business or profession" irrespective of what could strictly be described as "profits derived from the export of goods or merchandise out of India". The deduction is computed in the following manner :-**

Profit of the business x Export turnover
Total turnover

6. The term "export turnover" under the existing provisions, means the sale proceeds (excluding freight and insurance) receivable by the assessee in convertible foreign exchange. In other words, the FOB value of exports. The Finance Act, 1990 has restricted the definition of the term "export turnover" to mean FOB sale proceeds actually received by the assessee in convertible foreign exchange within six months of the end of the previous year or within such further period as the Chief Commissioner/Commissioner may allow in this regard.

9. Thus, in the case of an assessee who is doing export business exclusively, "export turnover and total turnover" would be identical, if the entire sale proceeds are brought into India in convertible foreign exchange within the prescribed time limit. In that case, the entire profit under the head "Profits and gains of business or profession" (which will include the three export (incentives) will be deductible under Section 80HHC. However, in order to arrive at the amount deductible under Section 80HHC in the case of an assessee doing export business as well as some other domestic business, the fraction of "export turnover" to "total turnover", will be applied to his profits computed under the head "Profits and gains of business or profession", (which again will include the three export incentives). The operation of section 80HHC read with section 28, as amended by the Finance Act, 1990, can be illustrated by way of the following examples :

	Code I	Code II	Code III	Code IV
	Exclusively export business	2/3 export 1/3 domestic sale	1/2 export 1/2 domestic sale	1/3 export 2/3 domestic sale

		(Figures in lakhs of rupees)			
(i)	Turnover				
	(a) FOB exports	100	100	100	100
	(b) Domestic rate	...	50	100	200
	(c) Total turnover	100	150	200	300
(ii)	Business profits before incentives (assumed figures)	10	15	20	30
(iii)	CCS, DDK,I/L	10	10	10	10
	Total Profits of the business	20	25	30	40
(iv)	Deduction u/s 80HHC if entire export proceeds, i.e. Rs.100 lakhs is brought into India within the stipulated period	= 20.00	25x 100/150 = 16.67	30 x 100/200 = 15.00	40 x 100/300 = 13.33
(v)	Deduction u/s 80HHC if only 50% of the export proceeds i.e., Rs.50 lakhs is brought into India	20 x 50/100 = 10.00	25x 50/150 = 8.33	30 x 50/200 = 7.50	40 x 29/300 = 6.62"

The above Circular indicates vide Para 4 of the Circular that Section 80HHC(3) statutorily fixes the quantum of deduction on the basis of a proportion of business profits

under the head "profits and gains of business or profession" irrespective of what could strictly be described as profits derived from export of goods out of India. Even in clause 9 the illustration given indicates that the ratio mentioned in sub-Section (3) has to be applied to business profits computed under the provisions of Sections 28 to 43D of the Income Tax Act. This Circular supports the reasoning given by us in our judgment hereinabove.

7. For the above reasons, we allow this civil appeal by setting aside the impugned judgment of the High Court with no order as to costs. We make it clear that our reasoning is strictly applicable to the law as it stood during the relevant Assessment Year.

.....J.
(S.H. KAPADIA)

.....J.
(B. SUDERSHAN REDDY)

New Delhi
September 03, 2008