Puneet Puri & Company

Chartered Accountants
1103, Naurang House,
21 K.G Marg,
New Delhi 110001
Tel:- +9111 41531466
Fax:- +9111 43505255
Website: www.ppcindia.co.in

SUBJECT : **Turnover parity, settled at last**

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The issue of export profit deduction has been a matter of controversy for quite sometime, primarily because the term 'total turnover' has not been defined in the law — Section 10A/10B of the Income-Tax Act. The revenue department however has been given a meaning that restricts the export profit deduction available to the assessees. However, the Bangalore Tax Tribunal in more that four cases had held that the meaning of total turnover has to be understood in the context in which the section has been enacted and held that in principle of parity what is excluded from export turnover has to be excluded from total turnover to give the right meaning.

Turnover parity, settled at last

Recently, the Tribunal of the Chennai Income-tax Appellate Tribunal (ITAT), settled the issue on parity of turnover in favour of the assessee *(ITO vs Sak Soft Ltd)*. This decision of the Tribunal is of significance as it sets at rest the principle to be applied while computing export profits deduction.Though the parity principle was accepted by the Bangalore Tribunal, the Supreme Court decision in the *CIT vs Ravindranathan Nair (295 ITR 228)* case was given an interpretation so as to negate the parity principle and this decision had come out in this context.

The Tribunal heard the case of the appellant as well as the interveners and the department. The Tribunal went into the genesis of the section, legislative intent, nature of expenditure as well the numerous judicial precedents before it reached the conclusion. It also clarified on the non-applicability of the *Nair* case and upheld the principle laid down in the apex court judgment in *CIT vs Lakshmi Machine Works [290 ITR 667]* . The Tribunal also held that expenditure on telecommunication, freight and insurance whether or not incurred in foreign exchange would be liable to be excluded from turnover.

The Tribunal also indicated that the assessing officer (AO) had the power to go behind the scenes to ascertain the portion of excludible expenditure, where the same was not recovered separately in the invoices.

The question referred to the Tribunal related to whether expenditure in foreign currency treated as attributable to the delivery of computer software outside India excluded from export turnover, ought to have been excluded from total turnover for computation of deduction under Section 10B of the Act.

Role of interpretation

The issue was that parity was required in order not to skew the formula for export profit deduction. Since Section 10B was a beneficial section, the ends of justice would not be served by artificial limitations on formula. Given the majority view and with the objective of harmonious construction, it was paramount to adopt the popular sense of the words and provide a uniform interpretation of the terms 'export turnover' and 'total turnover'.

The department countered this by saying that Explanation 2 of Section 10B defines the term 'export turnover' and the exclusions are not meant for 'total turnover'. Reference was made to judgments which had held that the courts cannot read anything into a statutory provision where such provisions are clear and unambiguous.

Rules of beneficial interpretation

The rule of beneficial interpretation on provisions granting relief from tax does not apply where there are express statutory provisions. Logic cannot supply what is not there in the Act. Support was drawn from the apex court decision in the Dharmendra Textile Processors (306 ITR 277) case and the Tribunal's decision in the Aztec Software (107 ITD 141) case, to submit that casus omissus cannot be created, unless absolutely necessary.

In response to these contentions, the Supreme Court ruling in the CIT vs Catapharma (India) P. Ltd (292 ITR 641) case was referred to which upheld the LMW decision. It was also submitted that accounting principles would not have any say in interpretation. Casus omissus was present in the instant case and it became important for the judiciary to supply the meaning.

It was seen that no definition of export and total turnover was first present in the section. However, when the Finance Act of 2000 revamped the section, 'export turnover' was defined but not 'total turnover'. The Explanatory Notes to the Finance Act do not throw light as to how total turnover should be ascertained.

The decisions of Sudarshan Chemicals and Chloride India Ltd (the latter specifically had decided this issue on first principles) were found to be important pointers since they had stressed that if there was disparity in the items included in the numerator and the denominator, the formula will become unworkable.

The Tribunal maintained that there is no violation of the principle of casus omissus and in this instance, such interpretation and supply of a meaning was required to be made.

Comparison of Sections

The assessee and interveners placed reliance on certain High Court and Tribunal judgments in the context of Sections 80HHC, 80HHD, 80HHE and 80HHF. Special emphasis was made in relation to decisions such as Lotus Trans Travels [290 ITR 1] and the Chloride India decision, which had upheld parity despite the absence of a definition of total turnover.

Reference was also made to the genesis of Section 80HHC, where the definition of total turnover was brought in retrospectively, to cure the anomaly present then. Given the commonality of objectives of these sections, it was argued that similar parity would hold good for Section 10A/10B as well.

Further, given the specific exclusion from total turnover in Section 80HHE, it was argued that Section 10A/10B would be on the same footing, in view of similarity of the sections.

The department however argued that Circular 564 was issued with reference to Section 80HHC and not Section 10B. No such amendment was made for Section 10B. Sections 80HHC, 80HHE and 80HHF all define both export and total turnover and are expressly for the purposes of those sections.

Section 10B was enacted prior to Section 80HHE and, therefore, cannot take the same colour of Section 80HHE or considered as the continuation of the latter.

The Tribunal examined the rationale behind the insertion of the definition of 'total turnover' with retrospective effect in Section 80HHC and it was concluded that the CBDT, in removing the anomaly in Section 80HHC supports the parity theory.

It was also observed that Sections 80HHC, 80HHE, 80HHF and 10A/10B had a common thread running through as all the provisions, granting relief to the assessee from profits derived from export. Words in provisions need a meaning, especially because the same needs to be applied in the formula. Therefore, the principle of harmonious construction would uphold the parity theory.

Nature of receipt

The assessee and intervener argued that reimbursement of expenses without profit element will not comprise 'turnover'. The software provider is not in the business of recovering such expenses incurred in the course of export. Reference was also drawn to the Guidance Note issued by the ICAI relating to tax audit under Section 44AB of the Act and the definition of the term in the Oxford Dictionary of Accounting and New Webster's Dictionary.

From the above it was interpreted that 'turnover' represents what is available with the assessee to be turned over and mere reimbursements of expenses are not of such nature. Given that expenses were sought to be excluded from export turnover, being mere reimbursements, the same would also not form a part of total turnover.

The Tribunal further mulled over the nature of receipts and the meaning of turnover. It was held that only these receipts which have an element of profit in them can constitute turnover. A receipt which does not have an element of turnover cannot find a place in the export or total turnover.

An element of turnover is missing in each of the cases of freight, telecom charges or insurance attributable to the delivery of goods. They were merely recovered by the assessee as reimbursement of such expenses incurred by him and cannot have an element of turnover. 'Consideration' can only refer to the price of the computer software exported out of India. And total turnover is nothing but the aggregate of domestic and export turnover. Therefore what does not form part of 'export turnover' cannot form part of 'total turnover'.

LMW vs Nair

The assessee and interveners placed reliance on the LMW decision where the SC recognised the need for parity between export turnover and total turnover for the purpose of Section 80HHC. They further submitted that the judgment of the Supreme Court in the Nair case had actually supported the cause of parity and the SC had chosen to not apply the principle in view of the specific definition constraints.

The assessee sought to distinguish these two decisions. The SC in the LMW case had compared 'export turnover' and 'total turnover'. However, in the Nair case, the comparison was between 'profits of business' and 'total turnover'.

Both rulings are applicable to different facts. In context of Section 10B the former ruling will apply. Given the above, it was clear that the ITAT's decision in the iSoft R&D Pvt. Ltd case had proceeded on an erroneous understanding of the Nair case and, therefore, concluded that parity can be upset.

The department argued that the LMW case is confined to the facts of that case and cannot be lifted and incorporated in Section 10B. The Nair case firmly rejects the parity theory. The Chennai Tribunal's orders of iSoft R & D Ltd, Changepond Software and California Software Co. Ltd have laid down the correct interpretation of the expression 'total turnover' appearing in Section 10B.

Both the Nair and LMW cases were examined and it was held that both cases had examined different facets of the formula and, therefore, are not comparable. In the context of Section 10B, only the LMW case, which supports the parity theory would have application. It was observed that the ITAT in the case of iSoft had indeed proceeded on an incorrect assumption, thereby rendering reliance on such decision to be misplaced.

Given the above reasoning, the Tribunal concluded that the freight, telecom charges or insurance attributable to the delivery outside India or expenses, if any, incurred in foreign exchange in providing the technical services outside India are to be excluded both from the export turnover and from the total turnover. The appeals filed by the department were therefore dismissed.

This decision brings clarity to the issue and would be helpful to all assessees involved in export activity. Further, given that it is a decision of a Special Bench, it would hold good across India, till any adverse analysis is concluded by a High Court.

Source: The Business Line