M/S LIBERTY INDIA

v.

COMMISSIONER OF INCOME TAX

(Civil Appeal No. 5891 of 2009)

AUGUST 31, 2009

[S.H. KAPADIA AND AFTAB ALAM, JJ.]

INCOME TAX ACT, 1961:

s. 80-IB – Profits and gains derived from eligible business – Duty drawback receipt/DEPB benefits – HELD: Do not form part of the net profits of eligible industrial undertaking for the purposes of ss. 80-I/80-1A/80-IB – Expression "derived from" occurring in s.80-IB is narrower in connotation as compared to words "attributable to" – By using expression "derived from", Parliament intended to cover sources not beyond the first degree – Profits derived by way of incentives, namely DEPB and duty drawback do not fall within the expression "profits derived from industrial undertaking".

ACCOUNTING STANDARDS:

AS-2 – Valuation of Inventories – Cost of Purchase – HELD: Duty drawback/DEPB benefits, rebates etc. cannot be credited against cost of purchase of manufacture of goods debited in the Profit and Loss account for purposes of s.80-A/80-1B – Department correctly applied AS-2.

Words and Phrases:

Expressions 'derived from' and 'attributable to' – Connotation of.

The assessee-appellant in CA No. 5891 of 2009, a partnership firm owning a small scale industrial undertaking, during the relevant previous year

A corresponding to Assessment Year 2001-02, claimed deduction u/s 80-IB of the Income Tax Act, 1961 on account of Duty Entitlement Passbook and Duty Drawback credited to Profit and Loss account. The Assessing Officer denied the deduction. When the matter B ultimately reached the High Court, it held that the assessee having failed to prove the nexus between the receipt by way of duty drawback/DEPB benefit and the industrial undertaking, was not entitled to deduction u/s 80-IB. The other appeals were filed in similar C circumstances.

The question for consideration before the Court was: whether profit from Duty Entitlement Passbook Scheme (DEPB) and Duty Drawback Scheme could be said to be profit derived from the business of the D industrial undertaking eligible for deduction u/s 80-IB of the 1961 Act.

Dismissing the appeals, the Court

E HELD: 1. Duty drawback receipt/DEPB benefits do not form part of the net profits of eligible industrial undertaking for the purposes of ss.80-1/80-1A/80-IB of the Income Tax Act, 1961. [Para 24] [1062-F]

2.1. The 1961 Act broadly provides for two types of F tax incentives, namely, investment linked incentives and profit linked incentives. Chapter VI-A which provides for incentives in the form of tax deductions essentially belongs to the category of "profit linked incentives". Therefore, when s. 80-IA/80-IB refers to profits derived G from eligible business, it is the generation of profits (operational profits), which attracts the incentives and not the ownership of that business. Parliament has thus confined deduction to profits derived from eligible businesses mentioned in sub-sections (3) to (11A) [as H they stood at the relevant time]. Besides, each of the

eligible business in sub-sections (3) to (11A) constitutes a stand-alone item in the matter of computation of profits. That is the reason why the concept of "Segment Reporting" stands introduced in the Indian Accounting Standards by the Institute of Chartered Accountants of India. [Para 13] [1057-C-H; 1058-A]

2.2. In Chapter VI-A, ss.80-IB/80-IA are the Code by themselves as they contain both substantive as well as procedural provisions. Section 80-IB provides for allowing of deduction in respect of profits and gains derived from the eligible business. The words "derived from" are narrower in connotation as compared to the words "attributable to". By using the expression "derived from", Parliament intended to cover sources not beyond the first degree. [Para 14] [1058-B-C]

2.3. Sub-section (13) of s.80-IB provides for applicability of the provisions of sub- section (5) and sub-sections (7) to (12) of s.80-IA, so far as may be, applicable to the eligible business u/s 80-IB. On perusal of sub-section (5) of s.80-IA, it is noticed that it provides for manner of computation of profits of an eligible business. Accordingly, such profits are to be computed as if such eligible business is the only source of income of the assessee. Therefore, the devices adopted to reduce or inflate the profits of eligible business has got to be rejected in view of the overriding provisions of sub-section (5) of s.80-IA, which are also required to be read into s. 80-IB as is evident from s. 80-IB(13). Thus, ss. 80-I, 80-IA and 80-IB have a common scheme and if so read it is clear that the said sections provide for incentives in the form of deduction(s) which are linked to profits and not to investment. On analysis of ss.80-IA and 80-IB it becomes clear that any industrial undertaking, which becomes eligible on satisfying sub-s. (2), would be entitled to deduction under sub-s. (1) only to the extent

A of profits derived from such industrial undertaking after specified date(s). Therefore, apart from eligibility, sub-s.(1) purports to restrict the quantum of deduction to a specified percentage of profits. This is the importance of the words "derived from industrial undertaking" as B against "profits attributable to industrial undertaking". [Para 15] [1058-H; 1059-A-E]

2.4. DEPB is an export incentive. It is given under Duty Exemption Remission Scheme. The object behind DEPB is to neutralize the incidence of customs duty C payment on the import content of export product. This neutralization is provided for by credit to customs duty against export product. Under DEPB, an exporter may apply for credit as percentage of FOB value of exports made in freely convertible currency. Credit is available D only against the export product and at rates specified by DGFT for import of raw materials, components etc. DEPB credit under the Scheme has to be calculated by taking into account the deemed import content of the export product as per basic customs duty and special additional E duty payable on such deemed imports. Therefore, DEPB/ Duty Drawback are incentives which flow from the Schemes framed by Central Government or from s.75 of the Customs Act, 1962, and therefore, incentive profits are not profits derived from the eligible business u/s.80-F IB. They belong to the category of ancillary profits of such Undertakings. [Para 16] [1059-F-H; 1060-A-B]

2.5. As regards the duty drawback, s.75 of the Customs Act, 1962 and s.37 of the Central Excise Act, 1944 empower Government of India to provide for G repayment of customs and excise duty paid by an assessee. The refund is of the average amount of duty paid on materials of any particular class or description of goods used in the manufacture of export goods of specified class. The Rules do not envisage a refund of H

an amount arithmetically equal to customs duty or central excise duty actually paid by an individual importer-cum-manufacturer. Sub-s. (2) of s.75 of the Customs Act requires the amount of duty drawback to be determined on a consideration of all the circumstances prevalent in a particular trade and also based on the facts situation relevant in respect of each of various classes of goods imported. Basically, the source of duty drawback receipt lies in s.75 of the Customs Act and s.37 of the Central Excise Act. [Para 17] [1060-C-E]

2.6. Analysing the concept of remission of duty drawback and DEPB, it makes clear 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, profits derived by way of such incentives do not fall within the expression "profits derived from industrial undertaking" in s.80-IB. [Para 18] [1060-F-G]

3.1. The Department has correctly applied AS-2, which 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 realizable 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. 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. Therefore, 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*

A *(credited) to cost of purchase* **or manufacture of goods. They should be treated as separate items of revenue or income and accounted for accordingly. [Para 20 to 23] [1062-A; 1060-H; 1061-A-D]**

B *Indian Accounting Standards & GAAP by Dolphy D'souza* **page 44, referred to.**

3.2. For the purposes of AS-2, Cenvat credits should not be included in the cost of purchase of inventories. Even Institute of Chartered Accountants of India has C **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 later stage) arising on** D **account of rebates, duty drawback, DEPB benefit etc. Profit generation could be on account of cost cutting, cost rationalization, business restructuring, tax planning on sundry balances being written back, liquidation of current assets etc. Therefore, duty drawback, DEPB** E **benefits, rebates etc. cannot be credited against the cost of manufacture of goods debited in the Profit and Loss account for purposes of ss.80-IA/80-IB as such remissions (credits) would constitute independent source of income beyond the first degree nexus between** F **profits and the industrial undertaking. [Para 22 and 23] [1061-D-H]**

CIT v. Sterling Food **237 ITR 579;** *CIT v. Kirloskar Oil Engines Ltd.* **[1986] 157 ITR 762, referred to.**

G *CIT v. Ritesh Industries Ltd.* **274 ITR 324;** *CIT vs.India Gelatine and Chemicals Ltd.* **275 ITR 284;** *Pandian Chemicals Ltd. v. CIT* **262 ITR 278 – cited.**

Case Law Reference:

H **237 ITR 579** **referred to** **para 5**

274 ITR 324	**cited**	**para 5**
275 ITR 284	**cited**	**para 8**
262 ITR 278	**cited**	**para 10**
[1986] 157 ITR 762	**referred to**	**para 14**

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 5891 of 2009.

From the Judgment & Order dated 22.9.2006 of the High Court of Punjab and Haryana at Chandigarh in ITA No. 590 of 2005.

WITH

Civil Appeal Nos. 5892-5898 of 2009 and Civil Appeal No. 5271 of 2007, 5571 of 2007, 1465 of 2008, 1499 of 2008, 1500 of 2008, 1438 of 2008, 1439 of 2008, 1440 of 2008, 1915 of 2008, 2408 of 2008, 2409 of 2008, 2411 of 2008, 2410 of 2008, 5157 of 2007, 3479 of 2008, 2648 of 2008, 4125 of 2008, 6217-6218 of 2008, 427 of 2009, 430 of 2009, 429 of 2009, 364-365 of 2009, 1257-1258 of 2009, 3532 of 2009 and 451 of 2006.

Gourab Banerji, A.S.G., S. Ganesh, (NP), Dr. Rakesh Gupta, Ashwani Taneja, Poonam Ahuja, Rajan Verma, S.K. Mukhi, Rameshwar Prasad Goyal, Shashi M. Kapila, Anoop Sharma, Malika Chaudhary, Charu Kapoor, Nupur Kanungo, Ram Raj, Vikas Mehta, Pankaj Jain, S.K. Sabharwal, Arun Jain, Jasbir Singh Malik, Preetesh Kapur, Radha Rangaswamy, Ajay Vohra, Kavita Jha, Sandeep S. Karhail, Pankaj Jain, M.K. Choudhary, Namita Choudhary, S.K. Verma, Ambhoj Kumar Sinha, Kailash Mittal, Sunil Mukhi, Gagan Gupta, Rajiv Tyagi, H. Raghavendra Rao, T.A. Khan and B.V. Balaram Das for the appearing parties.

The Judgment of the Court was delivered by

A **S.H. KAPADIA, J.** 1. Leave granted.

2. The issue for consideration is: whether profit from Duty Entitlement Passbook Scheme (DEPB) and Duty Drawback Scheme could be said to be profit derived from the business of the Industrial Undertaking eligible for deduction under B Section 80-IB of the Income-tax Act, 1961 (1961 Act)?

3. At the outset, we may indicate that although in the present judgment we have focused on the analysis of Section 80-IB, the basic Scheme of Sections 80I, 80-IA and 80-IB (as C they then stood) remains the same.

Facts:

4. The facts in the lead matter (Civil Appeal arising out of SLP(C) No. 5827/07 entitled *M/s Liberty India v. CIT*) are as D follows:

5. The appellant, a partnership firm, owns a small scale industrial undertaking engaged in manufacturing of fabrics out of yarns and also various textile items such as cushion covers, E pillow covers etc. out of fabrics/yarn purchased from the market. During the relevant previous year corresponding to Assessment Year 2001-02, appellant claimed deduction under Section 80-IB on the increased profits of Rs. 22,70,056.00 as profit of the industrial undertaking on account of DEPB and Duty Drawback credited to the Profit & Loss account. The Assessing Officer F denied deduction under Section 80-IB on the ground that the said two benefits constituted export incentives, and that they did not represent profits derived from industrial undertaking. In this connection the AO placed reliance on the judgment of this Court in *CIT v. Sterling Food* reported in 237 ITR 579. G Aggrieved by the said decision, matter was carried in appeal to CIT(A), who came to the conclusion, that duty drawback received by the appellant was inextricably linked to the production cost of the goods manufactured by the appellant; that, duty drawback was a trading receipt of the industrial H undertaking having direct nexus with the activity of the industrial

undertaking and consequently, the AO was not justified in denying deduction under Section 80-IB. According to CIT(A), the DEPB Scheme was different from Duty Drawback Scheme inasmuch as the DEPB substituted value based Advance Licencing Scheme as well as Passbook Scheme under the Exim Policy; that entitlements under DEPB Scheme were allowed at pre-determined and pre-notified rates in respect of exports made under the Scheme and consequently, DEPB did not constitute a substitute for duty drawback. According to CIT(A), credit under DEPB could be utilized by the exporter himself or it could be transferred to any other party; that such transfer could be made at higher or lower value than mentioned in the Passbook and, therefore, DEPB cannot be equated with the duty drawback, hence, the appellant who had received Rs. 20,95,740/- on sale of DEPB licence stood covered by the decision of this Court in *Sterling Food* (supra). Hence, to that extent, appellant was not entitled to deduction under Section 80-IB. Against the decision of CIT(A) allowing deduction on duty drawback, the revenue went in appeal to the Tribunal which following the decision of the Delhi High Court in the case of *CIT v. Ritesh Industries Ltd.* reported in 274 ITR 324, held that the amount received by the assessee on account of duty drawback was not an income derived from the business of the industrial undertaking so as to entitle the assessee to deduction under Section 80-IB.

6. The decision of the Tribunal was assailed by the assessee(s) under Section 260A of the 1961 Act before the High Court. Following the decision of this Court in *Sterling Food* (supra), the High Court held that the assessee(s) had failed to prove the nexus between the receipt by way of duty drawback/ DEPB benefit and the industrial undertaking, hence, the assessee(s) was not entitled to deduction under Section 80-IB(3), hence this Civil Appeal(s).

Arguments:

7. The submission of the appellant(s) [assessee(s)] in

A nutshell was that the amount of duty drawback/DEPB was intended to neutralize the incidence of duty on inputs consumed/ utilized in the manufacture of exported goods resulting into increased profits derived from the business of the industrial undertaking which profits qualified for deduction under Section B 80-IB. According to the appellant(s) since no excise duty/ customs duty was payable on raw materials consumed/utilized in manufacturing goods exported out of India, the duty paid stood refunded under Section 37(2)(xvia) of the Central Excise Act, 1944 and under Section 75 of the Customs Act, 1962 read C with Customs, Central Excise Duties and Service Tax Drawback Rules, 1995.

8. On the nature of DEPB it was submitted that the amount of DEPB was granted under Exim-Policy issued in terms of powers conferred under Section 5 of the Foreign Trade D (Development and Regulation) Act, 1992. According to the appellant(s), the DEPB Scheme is a Duty Remission Scheme which allows drawback of import charges paid on inputs used in the export product. The object being to neutralize the incidence of customs duty on the import content of the export E product by way of grant of duty credit. The DEPB benefit is freely transferable. Thus, according to the appellant(s), duty drawback/DEPB benefit received had to be credited against the cost of manufacture of goods/purchases debited to the Profit & Loss account. That, such credit was not an independent F source of profit. In this connection reliance has been placed on Accounting Standard-2 issued by ICAI on "valuation of inventories" which indicates that while determining cost of purchase, cost of conversion and other costs incurred in bringing the inventories to their present location and condition G should be considered and that trade discounts, rebates, duty drawback and such other similar items have to be deducted in determining the cost of purchase. Placing reliance on AS-2, it was submitted that where excise duty paid was subsequently recoverable by way of drawback, the same would not form part H of the manufacturing cost. It was submitted on behalf of the

appellant(s) that payment of excise duty/customs duty on inputs consumed in manufacture of goods by an industrial undertaking eligible for deduction under Section 80-IB, was inextricably linked to the manufacturing operations of the eligible undertaking without which manufacturing operations cannot be undertaken, hence the duty, which was paid in the first instance and which had direct nexus to the manufacturing activity when received back, had first degree nexus with the industrial activity of the eligible undertaking and consequently the reimbursement of the said amount cannot be treated as income of the assessee(s) *dehors* the expense originally incurred by way of payment of duty. Consequently, according to the appellant(s), receipt of duty drawback/DEPB stood linked directly to the manufacture/production of goods and therefore had to be regarded as profits derived from eligible undertaking qualifying for deduction under Section 80-IB of the 1961 Act. On behalf of the appellant(s) it was further submitted that this Court's decision in *Sterling Food* (supra) dealt with availability of deduction under Section 80-HH with respect to profit on sale of import entitlements. The said decision, according to the appellant, had no applicability to the issue under consideration for the reason that import entitlement/REP licence was granted by the Government on the basis of exports made; the same were granted gratuitously without antecedent cost having being incurred by the industrial undertaking, unlike duty drawback and DEPB, which had direct link to the costs incurred by such industrial undertaking by way of payment of customs/excise duty in respect of duty paid inputs used in the manufacture of goods meant for export and in such circumstances, profit from sale of import entitlements/REP licence was in the nature of windfall and it was in those circumstances, that the apex Court held that source of profit on sale of import entitlements was not the industrial undertaking but the source was the Export Promotion Scheme. According to the appellant(s), in the case of sale of import entitlements/REP licence, the source was the Scheme framed by Government of India whereas in the case of DEPB/ duty drawback, the source was the fact of payment of duty in

A respect of inputs consumed/utilized in the manufacture of goods meant for export. That, but for such payments of duty on inputs used in the manufacture of goods meant for exports, industrial undertaking(s) would not be entitled to the benefit of duty drawback/DEPB, notwithstanding, the Export Promotion B Scheme of the Government and, therefore, there was a direct and immediate nexus between payment of duty on such inputs and receipt of duty drawback/DEPB. In this connection reliance was placed on the judgment of the Gujarat High Court in the case of *CIT v. India Gelatine and Chemicals Ltd.* reported in C 275 ITR 284. Lastly, it was submitted on behalf of the appellant(s) that there was no difference between Advance Licence Scheme and duty drawback/DEPB. In this connection it was urged that duty drawback regime required the industrial undertaking to pay in the first instance the duty on inputs and thereafter seek reimbursement on profit of goods manufactured D using such duty paid inputs, having been exported. The industrial undertaking alternatively could avail of Advance Licence Scheme whereunder the industrial undertaking could import inputs to be used for manufacture of goods meant for export without payment of duty. In the case where the industrial E undertaking enjoyed the benefit of Advance Licence Scheme, the profit as shown in Profit & Loss account was regarded as income derived from industrial undertaking entitled to deduction under Section 80-IB of the 1961 Act without any adjustment whereas when the same industrial undertaking when it opts for F duty drawback is denied the benefit of deduction under Section 80-IB on the duty remitted.

9. On behalf of the appellant(s) it was submitted that Section 80-IB was different from Section 80-I in the sense that G under Section 80-IB, income derived from business of an industrial undertaking was admissible for deduction whereas under Section 80-I deduction was allowable to income derived from industrial undertaking. Hence, according to the appellant(s) provision of Section 80-IB was much wider in scope than H Section 80-I. According to the appellant(s) Section 80-IB was

wider than Section 80-I as the Legislature intended to give benefit of deduction not only to profits derived from the undertaking but also to give benefit of deduction in respect of incomes having direct nexus with the profits of the undertaking, hence, all incomes that arose during the course of running of the eligible business would be eligible for deduction under Section 80-IB, which would include income arising on sale of DEPB at premium.

10. In reply, Shri Gourab Banerji, learned Additional Solicitor General, submitted that, for application of the words "derived from" there must be a direct nexus between the profit and the industrial undertaking. According to the learned senior counsel, merely because under the Scheme to encourage exports a certain amount was repaid as "duty drawback", it cannot be regarded as profit "derived from" the industrial undertaking. It may constitute profit from business under Section 28, but it cannot be construed as profits "derived from" the industrial undertaking, for its immediate and proximate source was not the industrial undertaking but the scheme for "duty drawback". According to the learned counsel, this position was placed beyond doubt by a judgment of this Court in *Sterling Food* (supra). Therefore, according to the learned counsel, the source of duty drawback was not the industrial undertaking but the duty drawback scheme of the Central Government whereunder the duty drawback entitlement became available. According to the learned counsel, duty drawback, therefore, would stand on the same footing as import entitlements and could not be said to be derived from industrial undertaking. Reliance was also placed on the judgment of this Court in *Pandian Chemicals Ltd. v. CIT* reported in 262 ITR 278. According to the learned counsel, duty drawback was a matter of policy, hence, the proximate and immediate source of duty drawback cannot be industrial undertaking. On interpretation of Section 80-IB, learned senior counsel submitted that what was relevant for Section 80-IB(1) was profits derived from an eligible business. According to the learned counsel, various eligible

businesses are enumerated in sub-sections (3) to (11) of Section 80-IB. A perusal of sub-sections (3), (4) and (5) would also show that eligible business under those provisions means certain specific undertakings. In contrast, sub-sections (6) and (7) cover the business of a ship, hotel etc. Thus, for all practical purposes, according to the learned counsel, the section has used the words "eligible business" and "industrial undertaking" interchangeably and, therefore, there is no material difference between Section 80-I and Section 80-IB as in both cases profits have to be derived from an industrial undertaking.

11. *Relevant provisions of the Income Tax Act, 1961:*

Deductions to be made with reference to the income included in the gross total income.

80-AB. Where any deduction is required to be made or allowed under any section included in this Chapter under the heading "*C.-Deductions in respect of certain incomes*" in respect of any income of the nature specified in that section which is included in the gross total income of the assessee, then, notwithstanding anything contained in that section, for the purpose of computing the deduction under that section, the amount of income of that nature as computed in accordance with the provisions of this Act (before making any deduction under this Chapter) shall alone be deemed to be the amount of income of that nature which is derived or received by the assessee and which is included in his gross total income.

Deduction in respect of profits and gains from industrial undertakings after a certain date, etc.

80-I. (1) Where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking or a ship or the business of a hotel or the business of repairs to ocean-going vessels or other powered craft, to which this section applies, 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 profits and gains of an amount equal to twenty per cent thereof :

Provided that in the case of an assessee, being a company, the provisions of this sub-section shall have effect in relation to profits and gains derived from an industrial undertaking or a ship or the business of a hotel as if for the words "twenty per cent", the words "twenty-five per cent" had been substituted.

Deductions in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development, etc.

80-IA **(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 the profits and gains derived from such business for ten consecutive assessment years.

xxx

(4) This section applies to-

(i) any enterprise carrying on the business of (i) developing or (ii) operating and maintaining or (iii) developing, operating and maintaining any infrastructure facility which fulfils all the following conditions, namely :-

(a) it is owned by a company registered in India or by a consortium of such companies;

(b) it has entered into an agreement with the Central Government or a State Government or a local authority or

A any other statutory body for (i) developing or (ii) operating and maintaining or (iii) developing, operating and maintaining a new infrastructure facility;

(c) it has started or starts operating and maintaining the infrastructure facility on or after the 1st day of April, 1995:

B

Provided that where an infrastructure facility is transferred on or after the 1st day of April, 1999 by an enterprise which developed such infrastructure facility (hereafter referred to in this section as the transferor enterprise) to another C enterprise (hereafter in this section referred to as the transferee enterprise) for the purpose of operating and maintaining the infrastructure facility on its behalf in accordance with the agreement with the Central Government, State Government, local authority or statutory D body, the provisions of this section shall apply to the transferee enterprise as if it were the enterprise to which this clause applies and the deduction from profits and gains would be available to such transferee enterprise for the unexpired period during which the transferor enterprise E would have been entitled to the deduction, if the transfer had not taken place.

Explanation.-For the purposes of this clause, "infrastructure facility" means-

F (a) a road including toll road, a bridge or a rail system;

(b) a highway project including housing or other activities being an integral part of the highway project;

G

(c) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system;

(d) a port, airport, inland waterway or inland port;

H

(ii) any undertaking which has started or starts providing telecommunication services whether basic 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, 2003.

Explanation.-For the purposes of this clause, "domestic satellite" means a satellite owned and operated by an Indian company for providing telecommunication service;

(iii) any undertaking which develops, develops and operates or maintains and operates an industrial park or special economic zone notified by the Central Government in accordance with the scheme framed and notified by that Government for the period beginning on the 1st day of April, 1997 and ending on the 31st day of March, 2006:

Provided that in a case where an undertaking develops an industrial park on or after the 1st day of April, 1999 or a special economic zone on or after the 1st day of April, 2001 and transfers the operation and maintenance of such industrial park or such special economic zone, as the case may be, to another undertaking (hereafter in this section referred to as the transferee undertaking), the deduction under sub-section (1) shall be allowed to such transferee undertaking for the remaining period in the ten consecutive assessment years as if the operation and maintenance were not so transferred to the transferee undertaking;

(iv) an undertaking which,-

(a) is set up in any part of India for the generation or generation and distribution of power if it begins to generate power at any time during the period beginning on the 1st day of April, 1993 and ending on the 31st day of March, 2006 ;

(b) starts transmission or distribution by laying a network of new transmission or distribution lines at any time during

A the period beginning on the 1st day of April, 1999 and ending on the 31st day of March, 2006 :

Provided that the deduction under this section to an undertaking under sub-clause (b) shall be allowed only in relation to the profits derived from laying of such network
B of new lines for transmission or distribution;

(5) Notwithstanding anything contained in any other provision of this Act, the profits and gains of an eligible business to which the provisions of sub-section (1) apply
C shall, for the purposes of determining the quantum of deduction under that sub-section for the assessment year immediately succeeding the initial assessment year or any subsequent assessment year, be computed as if such eligible business were the only source of income of the
D assessee during the previous year relevant to the initial assessment year and to every subsequent assessment year up to and including the assessment year for which the determination is to be made.

Deduction in respect of profits and gains from certain
E *industrial undertakings other than infrastructure development undertakings*

80-IB **(1)** Where the gross total income of an assessee includes any profits and gains derived from any business referred to in sub-sections (3) to (11) and (11A) (such
F 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 from such profits and gains of an amount equal to such percentage
G and for such number of assessment years as specified in this section.

(2) This section applies to any industrial undertaking which fulfils all the following conditions, namely: -

H (i) it is not formed by splitting up, or the reconstruction, of

a business already in existence : A

Provided that this condition shall not apply in respect of an industrial undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such industrial undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section; B

(ii) it is not formed by the transfer to a new business of machinery or plant previously used for any purpose;

(iii) it manufactures or produces any article or thing, not C being any article or thing specified in the list in the Eleventh Schedule, or operates one or more cold storage plant or plants, in any part of India :

Provided that the condition in this clause shall, in relation D to a small scale industrial undertaking or an industrial undertaking referred to in sub-section (4) shall apply as if the words "not being any article or thing specified in the list in the Eleventh Schedule" had been omitted.

Explanation 1.-For the purposes of clause (ii), any E machinery or plant which was used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose, if the following conditions are fulfilled, namely:-

(a) such machinery or plant was not, at any time previous F to the date of the installation by the assessee, used in India;

(b) such machinery or plant is imported into India from any country outside India; and

(c) no deduction on account of depreciation in respect of G such machinery or plant has been allowed or is allowable under the provisions of this Act in computing the total income of any person for any period prior to the date of the installation of the machinery or plant by the assessee.

H

A Explanation 2.-Where in the case of an industrial undertaking, any machinery or plant or any part thereof previously used for any purpose is transferred to a new business and the total value of the machinery or plant or part so transferred does not exceed twenty per cent of the
B total value of the machinery or plant used in the business, then, for the purposes of clause (ii) of this sub-section, the condition specified therein shall be deemed to have been complied with;

(iv) in a case where the industrial undertaking
C manufactures or produces articles or things, the undertaking employs ten or more workers in a manufacturing process carried on with the aid of power, or employs twenty or more workers in a manufacturing process carried on without the aid of power.

D (3) The amount of deduction in the case of an industrial undertaking shall be twenty-five per cent (or thirty per cent where the assessee is a company), of the profits and gains derived from such industrial undertaking for a period of ten consecutive assessment years (or twelve consecutive
E assessment years where the assessee is a co-operative society) beginning with the initial assessment year subject to the fulfillment of the following conditions, namely: -

(i) it begins to manufacture or produce, articles or things
F or to operate such plant or plants at any time during the period beginning from the 1st day of April, 1991 and ending on the 31st day of March, 1995 or such further period as the Central Government may, by notification in the Official Gazette, specify with reference to any particular
G undertaking;

(ii) where it is an industrial undertaking being a small scale industrial undertaking, it begins to manufacture or produce articles or things or to operate its cold storage plant not specified in sub-section (4) or sub-section (5) at any time
H during the period beginning on the 1st day of April, 1995

and ending on the 31st day of March, 2002 . A

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(13) The provisions contained in sub-section (5) and sub-sections (7) to (12) of section 80-IA shall, so far as may be, apply to the eligible business under this section. B

Discussions and Findings:

12. In this batch of Civil Appeals we are concerned with admissibility of the amounts of duty drawback and DEPB for deduction under Section 80-IB. C

13. Before analyzing Section 80-IB, as a prefatory note, it needs to be mentioned that the 1961 Act broadly provides for two types of tax incentives, namely, investment linked incentives and profit linked incentives. Chapter VI-A which provides for incentives in the form of tax deductions essentially belong to D the category of "profit linked incentives". Therefore, when Section 80-IA/80-IB refers to profits derived from eligible business, it is not the ownership of that business which attracts the incentives. What attracts the incentives under Section 80-IA/80-IB is the generation of profits (operational profits). For E example, an assessee company located in Mumbai may have a business of building housing projects or a ship in Nava Sheva. Ownership of a ship *per se* will not attract Section 80-IB(6). It is the profits arising from the business of a ship which attracts sub-section (6). In other words, deduction under sub- F section (6) at the specified rate has linkage to the profits derived from the shipping operations. This is what we mean in drawing the distinction between profit linked tax incentives and investment linked tax incentives. It is for this reason that Parliament has confined deduction to profits derived from G eligible businesses mentioned in sub-sections (3) to (11A) [as they stood at the relevant time]. One more aspect needs to be highlighted. Each of the eligible business in sub-sections (3) to (11A) constitutes a stand-alone item in the matter of computation of profits. That is the reason why the concept of H

A "Segment Reporting" stands introduced in the Indian Accounting Standards (IAS) by the Institute of Chartered Accountants of India (ICAI).

14. Analysing Chapter VI-A, we find that Sections 80-IB/ 80-IA are the Code by themselves as they contain both B substantive as well as procedural provisions. Therefore, we need to examine what these provisions prescribe for "computation of profits of the eligible business". It is evident that Section 80-IB provides for allowing of deduction in respect of profits and gains *derived from* the eligible business. The words C "derived from" is narrower in connotation as compared to the words "attributable to". In other words, by using the expression "derived from", Parliament intended to cover sources *not* beyond the first degree. In the present batch of cases, the controversy which arises for determination is: whether the D DEPB credit/ Duty drawback receipt comes within the first degree sources? According to the assessee(s), DEPB credit/ duty drawback receipt reduces the value of purchases (cost neutralization), hence, it comes within first degree source as it increases the net profit proportionately. On the other hand, E according to the Department, DEPB credit/duty drawback receipt do not come within first degree source as the said incentives flow from Incentive Schemes enacted by the Government of India or from Section 75 of the Customs Act, 1962. Hence, according to the Department, in the present F cases, the first degree source is the incentive scheme/ provisions of the Customs Act. In this connection, Department places heavy reliance on the judgment of this Court in *Sterling Food* (supra). Therefore, in the present cases, in which we are required to examine the eligible business of an industrial G undertaking, we need to trace the source of the profits to manufacture. (see *CIT v. Kirloskar Oil Engines Ltd.* reported in [1986] 157 ITR 762)

15. Continuing our analysis of Sections 80-IA/80-IB it may be mentioned that sub-section (13) of Section 80-IB provides H for applicability of the provisions of sub-section (5) and sub-

sections (7) to (12) of Section 80-IA, so far as may be, applicable to the eligible business under Section 80-IB. Therefore, at the outset, we stated that one needs to read Sections 80I, 80-IA and 80-IB as having a common Scheme. On perusal of sub-section(5) of Section 80-IA, it is noticed that it provides for manner of computation of profits of an eligible business. Accordingly, such profits are to be computed as if such eligible business is the only source of income of the assessee. Therefore, the devices adopted to reduce or inflate the profits of eligible business has got to be rejected in view of the overriding provisions of sub-section (5) of Section 80-IA, which are also required to be read into Section 80-IB. [see Section 80-IB(13)]. We may reiterate that Sections 80I, 80-IA and 80-IB have a common scheme and if so read it is clear that the said sections provide for incentives in the form of deduction(s) which are linked to profits and not to investment. On analysis of Sections 80-IA and 80-IB it becomes clear that any industrial undertaking, which becomes eligible on satisfying sub-section(2), would be entitled to deduction under sub-section (1) only to the extent of profits derived from such industrial undertaking after specified date(s). Hence, apart from eligibility, sub-section(1) purports to restrict the quantum of deduction to a specified percentage of profits. This is the importance of the words "derived from industrial undertaking" as against "profits attributable to industrial undertaking".

16. DEPB is an incentive. It is given under Duty Exemption Remission Scheme. Essentially, it is an export incentive. No doubt, the object behind DEPB is to neutralize the incidence of customs duty payment on the import content of export product. This neutralization is provided for by credit to customs duty against export product. Under DEPB, an exporter may apply for credit as percentage of FOB value of exports made in freely convertible currency. Credit is available only against the export product and at rates specified by DGFT for import of raw materials, components etc.. DEPB credit under the Scheme has to be calculated by taking into account the

A deemed import content of the export product as per basic customs duty and special additional duty payable on such deemed imports. Therefore, in our view, DEPB/Duty Drawback are incentives which flow from the Schemes framed by Central Government or from Section 75 of the Customs Act, 1962, B hence, incentives profits are not profits derived from the eligible business under Section 80-IB. They belong to the category of ancillary profits of such Undertakings.

17. The next question is – what is duty drawback? Section 75 of the Customs Act, 1962 and Section 37 of the Central C Excise Act, 1944 empower Government of India to provide for repayment of customs and excise duty paid by an assessee. The refund is of the average amount of duty paid on materials of any particular class or description of goods used in the manufacture of export goods of specified class. The Rules do D not envisage a refund of an amount arithmetically equal to customs duty or central excise duty actually paid by an individual importer-cum-manufacturer. Sub-section (2) of Section 75 of the Customs Act requires the amount of drawback to be determined on a consideration of all the E circumstances prevalent in a particular trade and also based on the facts situation relevant in respect of each of various classes of goods imported. Basically, the source of duty drawback receipt lies in Section 75 of the Customs Act and Section 37 of the Central Excise Act.

F 18. 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 G incentives do not fall within the expression "profits derived from industrial undertaking" in Section 80-IB.

19. Since reliance was placed on behalf of the assessee(s) on AS-2 we need to analyse the said Standard.

H 20. 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 form of materials or supplies to be consumed in the production.

21. "Inventory" should be valued at the lower of cost and net realizable 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.

22. 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: page 44 of *Indian Accounting Standards & GAAP* by Dolphy D'souza). Therefore, for the purposes of AS-2, Cenvat credits should *not* be included in the cost of purchase of inventories. Even 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 later stage) arising on account of rebates, duty drawback, DEPB benefit etc. Profit generation could be on account of cost cutting, cost rationalization, business restructuring, tax planning on sundry balances being written back, liquidation of current assets etc. 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 & 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.

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

Expenditure	Amount (Rs.)	Income	Amount (Rs.)
Opening stock	100	Sales	1,000
Purchases (including customs duty paid)	500	Duty Drawback received	100
Manufacturing overheads	300	Closing stock	200
Administrative, Selling and Distribution Exp.	200		
Net profit	200		
	1,300		1,300

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

24. In the circumstances, we hold that Duty drawback receipt/DEPB benefits do not form part of the net profits of eligible industrial undertaking for the purposes of Sections 80I/ 80-IA/80-IB of the 1961 Act.

25. The appeals are, accordingly, dismissed with no order as to costs.

R.P. Appeals dismissed.