

(2023) 11 SC CK 0029

Supreme Court Of India

Case No: Civil Appeal No. 2664, 2665 Of 2011

Shah Originals

APPELLANT

Vs

Commissioner Of Income Tax-24,
Mumbai

RESPONDENT

Date of Decision: Nov. 21, 2023

Acts Referred:

- Income Tax Act, 1961 - Section 14, 28(iiid), 80HHC, 80HHC(1), 80HHC(3), 80HHC(baa), 260A
- Foreign Exchange Regulation Act, 1973 - Section 8(1), 73(3)

Hon'ble Judges: B.V. Nagarathna, J; S.V.N. Bhatti, J

Bench: Division Bench

Advocate: Jagdish Kumar Chawla, Balbir Singh, Arijit Prasad, Raj Bahadur Yadav, Rupesh Kumar, Shyam Gopal, Samarvir Singh, Shashank Bajpai

Final Decision: Dismissed

Judgement

„

S.V.N. Bhatti, J",,,

I. FACTUAL BACKGROUND,,

1. Shah Originals/assessee is the appellant in the subject Civil Appeals. The Commissioner of Income Tax-24, Mumbai/Revenue, is the respondent.",,,

The appeals arise from the orders dated 22.04.2010 in Income Tax Appeal Nos 431 and 996 of 2008 in the High Court of Judicature at Bombay. The,,

subject matter of the Civil Appeals relates to the assessment years 2000-01 and 2001-02. The appeals presented before this Court have a similar set,,

of facts and a common question for the decision of this Court and, hence, are disposed of by this common judgment.",,,

1.1 Civil Appeal No. 2664 of 2011 has been treated as the lead case. A reference to the circumstances, consideration and conclusions by the High",,

Court and the authorities in the lead appeal is sufficient for disposing of both the appeals before this Court.,,

1.2 The assessee claims to be a 100% Export-Oriented Unit (EOU). The assessee for the assessment year 2000-01 filed returns declaring the total,,

taxable income at Rs. 28,25,080/- (Rupees Twenty-Eight Lakhs Twenty-Five Thousand and Eighty). The assessee for the relevant assessment year",,

had adopted export turnover at Rs. 8,27,15,688/- (Rupees Eight Crores Twenty-Seven Lakhs Fifteen Thousand Six Hundred and Eighty-Eight). The",,

said turnover included an amount of Rs. 26,62,927/- (Rupees Twenty-Six Lakhs Sixty-Two Thousand Nine Hundred and Twenty-Seven) being gains",,

on accounts of foreign currency fluctuations in the assessment year 2000-01. The assessee treated the said earning from foreign currency as income,,

earned by the assessee in the course its export of goods/merchandise out of India, i.e., profits of business from exports outside India. The assessee",,

claimed deduction under Section 80 HHC of the Income Tax Act, for short, "the Act".",,

2. The Assessing Officer (AO), by the assessment order dated 10. 02.2006, disallowed the deduction claim of Rs. 26,62,927/- and added it to the",,

assessee's taxable income. The case of the Revenue is that gain/profit on account of foreign currency fluctuations in the Exchange Earners Foreign,,

Currency (EEFC) account cannot be attributed as an earning from the export of goods/merchandise outside India by the assessee. The assessee has,,

completed the export obligations and received the foreign exchange remittances from the buyers/importers of the assessee's goods. The credit of,,

the foreign currency in the EEFC account and positive fluctuation at the end of the financial year cannot be treated as the assessee's,,

income/receipt from the principal business, i.e., export of goods and merchandise outside India. It is pointed out by the Revenue that the Reserve Bank",,

Notification No. FERA.159/94-RB dated 01.03.1994 permitted foreign exchange earners to open and operate an EEFC account by crediting a,,

percentage of foreign exchange into the account. The guidelines issued in continuation of the Notification dated 01.03.1994 allow the units covered by,,

the notification to credit twenty-five per cent or as permitted, in the EEFC accounts and operate in foreign currency. In other words, the credit of",,,
foreign exchange to the EEFC account facilitates the foreign exchange earners to use the foreign currency in the EEFC account depending upon the,,
business necessities of the exporter.,,,

2.1 In the case at hand, the assessee received the foreign exchange remittances and credited the foreign exchange in the EEFC account. At the end",,,
of the financial year, the convertible foreign exchange value was reflected in the assessee's balance sheet. The assessee has gained/earned from the",,,
fluctuation in foreign currency credited to its EEFC account. Therefore, the maintenance of an EEFC account is neither necessary nor incidental in",,,
any manner to the export activity of the assessee. Crediting remittances or maintaining a balance in an EEFC account is akin to any deposit held by an,,
assessee in the Indian Rupee. The Revenue opposes the deduction under section 80 HHC because gains from foreign currency fluctuation are not a,,
profit derived from exporting goods/merchandise outside India. By the assessment order dated 10.02.2006, the deduction was disallowed. The",,,
assessee, aggrieved by the disallowance, filed an appeal before the Commissioner of Income Tax (Appeals), who dismissed the assessee's appeal by",,,
the order dated 21.11.2006. The assessee filed the ITA No. 1254/MUM/2007 before the Income Tax Appellate Tribunal, Mumbai. On 25.10.2007, the",,,
Appellate Tribunal, by the common order dated 25.10.2007, set aside the disallowance of the deduction claimed under Section 80 HHC of the Act of",,,
the gains earned on account of foreign exchange fluctuations. The Revenue filed an appeal under Section 260(A) of the Act, and through the",,,
impugned judgment, the appeal at the instance of Revenue was allowed, resulting in restoring the disallowance of the deduction under Section 80 HHC",,,
of the Act. Hence, the appeal at the instance of the assessee.",,,

II. SUBMISSIONS BY PARTIES,,

3. Mr. V.P. Gupta, learned counsel for the assessee, contends that the assessee is a 100% EOU. In the subject assessment year, the assessee has",,,
earned foreign currency from the export of garments outside India and, as provided by notification dated 01.03.1994, has credited a portion of foreign",,,

currency earned in the EEFC account. To meet the business exigencies, the assessee has used the credited amount in the EEFC account to promote",,,

or meet its business needs. Section 80 HHC provides for a deduction of profits of business from exports. The High Court erred by not noticing that the,,

foreign exchange is chargeable or computed under the head "profits and gains of business or profession". The High Court answered the question,,

framed, viz., whether the Tribunal was right in setting aside the disallowance of gain earned from foreign exchange fluctuations by the assessee",,,

without recording findings on crucial matters in issue.,,

3.1 It is argued that sub-section (1) of Section 80 HHC allows the deduction of profits of business derived from exports of goods/merchandise outside,,

India. Sub-section (1) of Section 80 HHC is appreciated by also applying sub-section (3) of the section. The combined reading of sub-sections (1) and,,

(3) of Section 80 HHC would bring the gain from foreign exchange within the fold of profits from the business of exports outside India. The said sub-,,

section (3) provides that profits derived from export shall be the amount which bears to the business's profit, the same proportion as the export",,,

turnover with the total business turnover carried on by the assessee. Clause (baa) of the Explanation to Section 80 HHC clearly states that the profit,,

of the business, as computed under the head "profits and gains of business or profession", is reduced by ninety percent of the items mentioned",,,

therein, including interest. The income under the head "profits and gains of business or profession" is arrived in the manner provided under",,,

Section 80 HHC by keeping the CBDT Circular No. 347 dated 07.07.1982 in perspective. The conversion of foreign currency into Indian Rupee at the,,

closure of the financial year is revenue in nature and is ancillary and incidental to the business of the assessee. Therefore, the profit or loss on account",,,

of conversion of the foreign currency is of revenue account or trading asset or as a part of circulating capital, and the gain from foreign exchange",,,

fluctuation comes within the permissible deduction of Section 80 HHC of the Act. He places strong reliance on *Sutlej Cotton Mills Ltd. v.*,,

Commissioner of Income Tax, Calcutta (1978) 4 SCC 358 and *Commissioner of Income Tax, Delhi v. Woodward Governor India Pvt. Ltd* (2009) 13",,,

SCC 1. The Learned Counsel also places reliance on Commissioner of Income Tax and Anr. v. Motorola India Electronics (P) Ltd. (2013) SCC,,

OnLine Kar 10731 and contends that the ratio therein directly deals with the contingencies of an EEFC account. He argues that a direct nexus exists,,

between the gain from foreign exchange fluctuation and the assessee's business income from exports. The deposit of funds in an EEFC account is,,

appreciated from the business perspective of the exporter; denying or disallowing deduction under Section 80 HHC is illegal. In fine, the arguments",,,

are:-,,

i. The foreign exchange credited to the EEFC account is a direct revenue from the export of garments.,,,

ii. The foreign exchange credited to the EEFC account is used for the business purposes of the assessee.,,,

iii. The exchange fluctuation is incidentally attributable to the business of the assessee, and necessarily, the deduction under Section 80 HHC is",,,

available.,,,

iv. The computation of business income is correctly carried out by the assessee by applying Clause (baa) of Section 80 HHC.,,,

v. A combined reading of sub-sections (1) and (3) applies to Section 80 HHC.,,,

4. Mr. Arijit Prasad, learned senior counsel appearing for the Revenue, argued that whether the deduction claimed under Section 80HHC is a profit",,,

derived from the export business depends on each case's facts and circumstances. None of the precedents relied upon by the assessee deals with a,,

foreign exchange fluctuation. The case on hand deals with profit or gain earned by the assessee on the fluctuation of foreign currency maintained in,,

the EEFC account. The deduction attracts strict compliance with Section 80 HHC of the Act. Before appreciating the effect of gain or loss of foreign,,

exchange fluctuation on profits of business from exports, this Court could consider the scheme under which the assessee is allowed to credit the",,,

foreign currency in EEFC accounts.,,,

5. The Reserve Bank of India (RBI), through Notification No. FERA.159/94-RB dated 01.03.1994 permitted an EOU or a unit located in a unit",,,

processing zone/park in Software Technology Park or Electronic Hardware Technology Park to open and operate an EEFC account with an,,

authorized dealer and credit to such an EEFC account up to fifty percent of any foreign exchange remittances received from outside India. The,,
guidelines provide the method and manner of opening and operating an EEFC account. According to the learned senior counsel, an EEFC account is",,,
an adjunct/facility provided by the RBI to the 100% EOUs to credit foreign exchange earnings in the EEFC account and transact in foreign exchange,,
on overseas commitments from the said account. The EEFC account is a facilitator rather than a mandatory requirement for doing export business or,,
earning foreign exchange. It is argued that opening an EEFC account is not even an adjunct for necessarily doing export business of garments by the,,
assessee. According to Mr. Arijit Prasad, the credit by the assessee is like a transfer/deposit into a bank account. In the case at hand, the foreign",,,
exchange currency maintained by the assessee had positive appreciation from the date of receipt till the end of the financial year. The earned foreign,,
exchange appreciation is not a derived income from the business activity of the assessee, namely, the export of goods/merchandise outside India.",,,
Section 80 HHC conspicuously refers to the words "derived from" to merit a deduction under Section 80 HHC of the Act. The expression,,
"derived from" ought not to be understood or interpreted as "attributable to". He places strong reliance on Pandian Chemicals Ltd. v.,,
Commissioner of Income Tax, Madurai (2003) 5 SCC 590 for the interpretation commended on the expression "derived from". The expression",,,
must be literally understood, and the ambit of deductions is not expanded through interpretation. He invites our attention to the judgment under appeal",,,
and the orders of the AO/CIT to contend that the findings of fact disallowing the deduction of gains in the EEFC account from foreign exchange,,
fluctuation are well-founded. The credit is independent of the business of exports, and earning is a passive earning of the assessee. Therefore, the",,,
income claimed as a deduction must have a direct nexus with the main business activity and be a derivative income from that activity. The,,
disallowance of deduction under Section 80 HHC is justified in law, and no ground is made for interference.",,,

III. ANALYSIS,,

6. In the above narrative, the question that falls for our consideration is whether the gain on foreign exchange fluctuation in the EEFC account of the assessee partakes the character of profits of the business of the assessee from exports and can the gain be included in the computation of the deduction under profits of the business of the assessee under Section 80 HHC of the Act?

6.1 The admitted circumstances are that the assessee is a 100% EOU of garments. In the subject financial year, the assessee recorded the turnover

of exports and the profits from the export of goods and merchandise outside India. It is also admitted that the assessee, without delay, received the

consideration against the goods exported. With respect to the foreign exchange earned from the exports of goods, instead of converting the exchange

immediately to Indian currency, the assessee credited a percentage of the foreign exchange to the EEFC account. The assessee received a gain of

Rs. 26,62,927/- from the amount credited to the EEFC account due to an upward revision in the exchange rate at the end of the financial year. The

assessee claimed deduction of gains from fluctuation in foreign currency under Section 80 HHC of the Act. The assessee argues that, firstly, EEFC is

an enabling account for an exporter of the categories covered by the RBI Notification dated 01.03.1994; secondly, the account holders are authorised

to meet their overseas financial commitments from the foreign exchange credited in their EEFC account. Therefore, the EEFC account is used for the

assessee's business; hence, the gain in foreign exchange fluctuation is treated as profits of business while computing the permissible deduction

under Section 80 HHC of the Act.

6.2 The Revenue has not denied the deduction of profits of business earned from the export of goods and merchandise to the assessee. The Revenue

contends that crediting foreign exchange earned in an EEFC Account is only an enabling facility provided by the RBI to the export earners and the

EEFC account, and the account does not have much to do with the business of the assessee, viz., export of garments. The opening and running of an

EEFC account are not mandatory for any exporter, but it facilitates transactions in foreign exchange from the account of the assessee. In other words,

it is neither necessary nor incidental for doing export business of garments but is purely optional. Therefore, the gains earned from foreign exchange",,

fluctuation of the amount credited in the EEFC account cannot be treated as profit from the export business of garments for deduction under Section,,

80 HHC of the Act.,,

7. We find it useful to set out beforehand the origin, scheme, and advantage of opening and maintaining an EEFC account by a 100% EOU or a unit",,

located in the Export Processing Zone, Software Technology Park, or Electronic Hardware Technology Park. Notification No. FERA.112/92/RB",,

dated 12.03.1992 permits opening an EEFC Account. This Notification has been issued under sub-section (1) to Section 8 read with sub-section (3) to,,

Section 73 of the Foreign Exchange Regulation Act, 1973 (the FERA). This Notification aims to facilitate an account separately maintained with the",,

foreign currency received by an exporter. The said permission granted by the RBI has to be equated with a facility to an exporter of one or the other,,

categories referred to in the Notification and maintain the transactions in foreign exchange conforming to the FERA.,,

7.1 The guidelines issued for the EEFC account are placed as Annexure-P1 in the Civil Appeal. We have perused the guidelines and appreciate their,,

object. The guidelines show how the amounts in foreign exchange are credited and the bonafide use of amounts separately credited or parked in the,,

EEFC account. The amount credited to an EEFC account represents foreign currency. The foreign currency/exchange rate is susceptible to upward,,

or downward value. By the Notification and Annexure-P1, we record that opening and maintaining an EEFC account is not a mandatory requirement",,

for export business or earning profits in the business of export outside India. Had the gain been on account of any statutory scheme, the ratio in",,

Topman Exports v. Commissioner of Income Tax, Mumbai 2012 (3) SCC 593 is attracted and applied. On referring to the Notification dated",,

01.03.1994 we hold that the EEFC account is a facility under the FERA. Therefore, we must necessarily examine the gain from foreign currency",,

fluctuation from the perspective of Section 80 HHC.,,

7.2 Let us refer to the judgment reported in Topman Exports (supra). The case considers a situation, viz., statutory flair/character of the revenue",,

receipt and treatment, as eligible for deduction under Section 80HHC. The case considers the interplay between Section 28 Clause (iii-d) and Section",,,

80 HHC of the Act. The controversy in Topman Exports (supra) was that the assessee was claiming a deduction of Rs. 83,69,303/- (Rupees Eighty",,,

Three Lakhs Sixty-Nine Thousand Three Hundred and Three) under Section 80HHC of the Act on the sale of Duty Entitlement Pass Book (DEPB),,,

and Duty-Free Replenishment Certificate (DFRC), which had accrued to the assessee on the export of its products. This Court directed the AO to",,,

compute the deduction under Section 80HHC of the Act and observed that the DEPB/ Duty Drawback is relatable to the cost of manufacture and",,,

has a direct nexus with the cost of imports. The relevant paragraphs are as follows:
",,,

â€œ37. â€ that where an assessee has an export turnover exceeding Rs 10 crores and has made profits on transfer of DEPB under clause",,,

(iii-d) of Section 28, he would not get the benefit of addition to export profits under the third or fourth proviso to sub-section (3) of Section 80-",,,

HHC, but he would get the benefit of exclusion of a smaller figure from â€œprofits of the businessâ€ under Explanation (baa) to Section 80-",,,

HHC of the Act and there is nothing in Explanation (baa) to Section 80-HHC to show that this benefit of exclusion of a smaller figure from",,,

â€œprofits of the businessâ€ will not be available to an assessee having an export turnover exceeding Rs 10 crores. In other words, where",,,

the export turnover of an assessee exceeds Rs 10 crores, he does not get the benefit of addition of ninety per cent of export incentive under",,,

clause (iii-d) of Section 28 to his export profits, but he gets a higher figure of profits of the business, which ultimately results in computation",,,

of a bigger export profit.,,,

38. The High Court, therefore, was not right in coming to the conclusion that as the assessee did have the export turnover exceeding Rs 10",,,

crores and as the assessee did not fulfil the conditions set out in the third proviso to Section 80-HHC(3), the assessee was not entitled to a",,,

deduction under Section 80-HHC on the amount received on transfer of DEPB and with a view to get over this difficulty the assessee was",,,

contending that the profits on transfer of DEPB under Section 28(iii-d) would not include the face value of DEPB.â€,,

8. The assessee further contends that the Judgment under appeal has not recorded a finding on whether or not the foreign exchange difference could,,

be chargeable under the head â€œprofits and gains of business and professionâ€. The judgment under appeal has not referred to sub-section (3) of,,

Section 80 HHC of the Act. A combined reading of sub-sections (1), (2) and (3) of Section 80 HHC of the Act, read with Clause (baa) of the",,,

Explanation to Section 80 HHC, would include the gain from foreign exchange fluctuation.",,

8.1 Per contra, the reply of learned counsel appearing for the Revenue is that Section 80 HHC deals with a permissible deduction while computing the",,,

assesseeâ€™s tax liability. The provisions of a tax statute are interpreted strictly, and the literal meaning of the expression â€œderived fromâ€ ought",,,

not to be confused with the words â€œattributable toâ€. Interpreting literally, it is contended that the words â€œderived fromâ€ mentioned in sub-",,,

sections (1) and (3) would be the deciding factor whether the gain from the foreign exchange fluctuation forms a part of the business income of the,,

assessee or not. We may refer to the illustration given by Mr. Arijit Prasad; the crediting of foreign exchange into an EEFC account is like,,

transferring from one account to another, and the gain from foreign exchange appreciation is, in no way, attributable to the assesseeâ€™s business of",,,

export of goods or merchandise outside India. The foreign exchange fluctuation resulting in gain, disallowed under Section 80 HHC, is looked at by",,,

tracing the origin of income or the source from which the gain is derived. The gain cannot be given the status of profits from the business of exports,,

unless the gain is said to be derived from the business of exports of goods/merchandise. The learned senior counsel argues that if the foreign currency,,

fluctuation gain is included in Section 80 HHC, all the incomes earned by the assessee will come under the head â€œprofit or gain from business or",,,

professionâ€, and no other head under Section 14 of the Act is attracted.",,

8.2 The Counsel for Revenue explains that a foreign exchange appreciation gain due to a delayed remittance is a different consideration. In the,,

subject assessment year, the assessee's case is not that there is a delay in the receipt of the sale price and the gain has occasioned in the delayed",,,

period. The case at hand is of a credit of a certain percentage of foreign exchange earnings in an EEFC account, and the credited amount has",,,

appreciated in Rupee convertibility at the end of the financial year. The findings of fact on the nature of the investment and the circumstances in",,,

which gains are earned by the dealer, disallowing the deduction under Section 80 HHC, in the facts and circumstances of the case, are valid and",,,

tenable.,,,

9. We have perused the citations Mr. V. B. Gupta, learned counsel appearing for the assessee, has placed a strong reliance on. The cases relied on by",,,

the assessee are clearly distinguishable on the point of deciding the appeal. The ratio does not apply to the facts and circumstances of the case.,,,

Hence, we are not adverting to them in detail or explaining why these decisions are distinguishable.",,,

9.1 Section 80 HHC of the Act reads as follows:,,

â€œS.80HHC. Deduction in respect of profits retained for export business.- Where an assessee, being an Indian company or a person",,,

(other than a company) resident in India, is engaged in the business of export out of India of any goods or merchandise 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 to the extent of profits, referred to in sub-section (1B), derived by the assessee from the export of such goods or",,,

merchandise.,,,

Provided that if the assessee, being a holder of an Export House Certificate or a Trading House Certificate, (hereinafter in this section",,,

referred to as an Export House or a Trading House, as the case may be,) issues a certificate referred to in clause (b) of sub-section (4A)",,,

that in respect of the amount of the export turnover specified therein, the deduction under this sub-section is to be allowed to a supporting",,,

manufacturer, then the amount of deduction in the case of the assessee shall be reduced by such amount which bears to the total profits",,,

derived by the assessee from the export of trading goods, the same proportion as the amount of export turnover specified in the said",,,

certificate bears to the total export turnover of the assessee in respect of such trading goods.,,,

xxx xxx xxx,,

xxx xxx xxx,,

(3) For the purposes of sub-section (1),-",",,

(a) where the export out of India is of goods or merchandise manufactured or processed by the assessee, the profits derived from such",,,

export shall be the amount which bears to the profits of the business, the same proportion as the export turnover in respect of such goods",,,

bears to the total turnover of the business carried on by the assessee;,,

(b) where the export out of India is of trading goods, the profits derived from such export shall be the export turnover in respect of such",,,

trading goods as reduced by the direct costs and indirect costs attributable to such export. (emphasis supplied),,,

S. NO.,NOMINAL INDEX,OBSERVATION

1.,"Commissioner of Income Tax,

Karnataka v. Sterling Foods,

Mangalore (1999) 4 SCC 98","There must be, for the application of the words

â€œderived fromâ€, a direct nexus between the

profits and gains and the

industrial undertaking.

2.,"Pandian Chemicals Ltd. v.

Commissioner of Income Tax,

Madurai (2003) 5 SCC 590","The words â€œderived fromâ€ in Section 80-HH of

the Income Tax Act, 1961 must be understood as

something which has direct

or immediate nexus with the appellant's industrial

undertaking.

3., "Commissioner of Income Tax v.

Willamson Financial

Services and Ors. (2008) 2 SCC

202", "The word 'derived' occurring in Section

80HHC of the Act would mean 'derived from

source'™ under Section 14 of the Act.

4., "Hindustan Lever Ltd. v.

Commissioner of Income- Tax,

Bombay City-I (1980) 121 ITR

951 (Bom)", "The word 'derived' as far as income tax law is

concerned has been given a narrow meaning. In

other words, only the proximate source has to be

considered and not the source to which it may

ultimately be

referable.

5., "Ahmedabad Manufacturing and

Calico Printing Co. Ltd.

v. Commissioner of Income-Tax,

Gujarat-I (1982) 137 ITR 616

(Guj)", "(i) There must be a direct nexus between the activity

of export and the earning of profit or gains for

application of the expression 'derived from export.

(ii) As discussed above, the word 'derive' as

far as income-tax law is concerned, has been given

a narrow meaningâ€"a restricted meaningâ€"by the

courts and has been understood in the restricted

sense of a direct derivation and not understood in the

broad sense as equivalent to derived directly or

indirectly.

6., "Commissioner of Income- Tax v.

Eastern Seafoods Exports (P.)

Ltd. (1995) 215 ITR 64 (Mad)", "The term "derived" occurring in Section 80J of

the Act is not a term of art. Profits or gains can be

said to have been "derived" from an activity

carried on by a person only if the said activity is the

immediate and effective

source of such profits or gains.

7., "Commissioner of Income- Tax v.

Viswananthan and

Co. (2003) 261 ITR 737 (Mad)", "The expression "derived from" means to get or

trace from a source. It is narrower than the term

attributable to.

8., "Kirloskar Electrodyn Ltd.

v. Deputy Commissioner of

Income-Tax 2003 SCC OnLine

ITAT 25", "The term "derived from" has a definite but

narrow meaning. It cannot receive a flexible

or wider connotation.