



## **Special Bench of the Tribunal rules that for computation of tax holiday benefit the doctrine of parity should be applied i.e. certain expenditure should be excluded both from export turnover and from total turnover**

Recently, the Chennai Special Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Sak Soft Ltd.<sup>1</sup> held that freight, telecom expenditure, and insurance charges, whether incurred in foreign exchange or INR would need to be treated in the same manner, i.e., need to be excluded from 'Export turnover'. The Special Bench applied the parity theory and held that such exclusions would also be warranted from 'Total turnover'.

### **Facts of the case**

The taxpayer company was engaged in the export of computer software and was claiming deduction under section 10B of the act. The Assessing Officer (AO) had deducted expenditure incurred in foreign currency outside India amounting to INR 2,907,056, from export turnover, however did not deduct the same from the total turnover, while computing the deduction under section 10B of the Income-tax Act, 1961 (the Act).

### **Issues raised before the Special Bench of the Tribunal**

When the expenditure in foreign currency, treated as attributable to the delivery of computer software outside India, is excluded from export turnover, whether the same should also be excluded from total turnover for the purpose of computation of deduction under section 10B of the Act?

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<sup>1</sup> *ITO v. Sak Soft Ltd. (ITA No 691 & 1953/Mds/2007), dated 6 March 2009 (Special Bench) (Chennai)*

Whether freight, telecom expenditure, insurance charges or expenditure in foreign expenditure required to be excluded from export turnover ought to be also excluded from total turnover?

### **Taxpayer's contentions**

- There should be parity between the amounts of the export turnover and total turnover. Despite no definition of 'total turnover' in Section 10B, the same has to be construed logically and harmoniously. The parity theory was upheld in the cases of *Tata Elxsi Ltd.*<sup>2</sup> and *Chloride India LTD*<sup>3</sup> even before the definition of total turnover was inserted in section 80HHC of the Act. Reliance was also placed on the decisions of the Supreme Court in *Lakshmi Machine Works*<sup>4</sup> (LMW decision) and *Lotus Trans Travels P. Ltd.*<sup>5</sup> where the courts have recognised the need for parity between export turnover and total turnover.
- Attention was drawn to Circular No.528, dated 16 December 1988 where it was stated that section 10B was inserted with a view to providing further incentive for earning foreign exchange and to secure that the income of a hundred percent EOU shall be exempt from tax and Circular 564, which has recognized the need to adopt a uniform interpretation of 'export turnover' and 'total turnover'
- Reference was made to Section 80HHE which defines the term 'total turnover' to exclude any freight, telecommunication charges, or insurance attributable to the delivery of computer software outside India.
- The decision of the Supreme Court in the case of *CIT vs. Ravindranathan Nair*<sup>6</sup> had actually supported the cause of parity and the Court had chosen not to apply the principle in view of the specific definition constraints.
- Since section 10B is a beneficial provision it should be interpreted liberally.
- Reimbursement of expenditure without profit element will not comprise 'turnover'. Further it is not in the business of the software provider to recover telecommunication charges incurred in the course of export. The concept provided in section 80HHE is to be incorporated in section 10B.

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<sup>2</sup> *Tata Elxsi Ltd. v. ACIT 115 TTJ 423 (Bang )*

<sup>3</sup> *Chloride India LTD v. DCIT 256 ITR 625 (Cal )*

<sup>4</sup> *CIT v Lakshmi Machine Works 290 ITR 667 (SC)*

<sup>5</sup> *CIT v. Lotus Trans Travels P. Ltd. 290 ITR 1 (Del)*

<sup>6</sup> *CIT v. Ravindranathan Nair 295 ITR 228 (SC)*

### **Tax Department's contentions**

- The Ravindranathan Nair's case firmly rejects the parity theory
- Explanation 2 of Section 10B defines the term 'export turnover' and the exclusions are not meant for 'total turnover'. Sections 80HHC, 80HHE and 80HHF all define both export and total turnover and are expressly for the purposes of those sections and the same cannot be automatically imported onto the reading of 10A and 10B
- Circular 564 was issued with reference to section 80HHC and not with reference to section 10B. No such amendment was made for section 10B. Similarly The LMW case is confined to the facts of that case and cannot be lifted and incorporated in section 10B.
- Various court decisions were relied on to contented that the courts cannot read anything into a statutory provision where such provisions are clear and unambiguous.
- The rule of beneficial interpretation on provisions granting relief from tax does not apply where there are express statutory provisions.

### **The Special Bench ruling**

- Section 10B first introduced in assessment year 1989-90 did not have definitions for the terms export as well as total turnover as it was not linked to any formula. Later when the Finance Act of 2000 revamped the section, 'Export turnover' was defined but not 'Total turnover'. Only those receipts which have an element of profit in them can constitute 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 taxpayer as reimbursement of such expenditure incurred by him and cannot have an element of turnover.
- The explanatory notes to the Finance Act 2000 explain how to arrive at deduction under section 10B but does not throw light as to how total turnover should be ascertained.
- The decisions of Sudarshan Chemicals and Chloride India Ltd. were examined where it was held that if there is a disparity in the items included in the numerator and the denominator, the formula will become unworkable.
- The taxpayer had contended that the processing charges would be included in the business profits, but given no nexus to export activity, the same would be excluded from the total turnover in the formula. The Supreme Court had held that every income may not be

attributable to the exports. Indirect taxes like excise duty which are recovered by the tax payers for and on behalf of the Government shall not be included in the total turnover in the formula as held in the LMW's case. Independent income similar to rent, commission, brokerage etc., is to be reduced to the extent of 90% from profits of business, however they were includable in the 'total turnover' in the formula. The Supreme Court thus made a distinction between the ratio laid down in the case of LMW, only in view of such specific definition. Therefore, the LMW's case and the Ravindranathan Nair's case are independent.

- A receipt which does not have an element of turnover cannot find a place in the export or total turnover. Further circular No.621 dated 19 December 1991 amended the definition of 'profits of the business' to clarify that such receipts which do not have an element of turnover will not be included as profits of the business to the extent of 90%, a deduction of 10% being given towards common expenditure.
- On application of the parity principle it follows that whatever has been excluded from the export turnover shall also be excluded from the total turnover as it was held in the Chloride India's case.
- 'Consideration' can only refer to the price of the computer software exported out of India. Further 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'.
- An ancillary question commented upon in this regard was where expenditure incurred in foreign exchange in providing technical services are not mentioned in the invoice raised, the AO will have the power to go behind the invoice and find out how much of the invoice amount pertains to the recovery of the aforesaid items.
- It was observed that sections 80HHC, 80HHE and 80HHF had a common thread running through as all the provisions granted relief to the taxpayer from profits derived from export. Section 10A and 10B were also provisions granting relief to the taxpayers in respect of their export profits. All the sections encouraged earning of foreign exchange and provide incentive to promote exports and have 'uniformity in object'.
- Applying the principles of harmonious construction there is no reason why the parity cannot be maintained between export turnover and total turnover, simply because the term 'total turnover' has not been defined in the section.
- Since the Parliament has not defined the term 'total turnover' in section 10B, nor there has been any circular indicating the same, it necessitates a consistent and uniform construction of the words having regard to the scheme and purpose of the incentive provision.

- The Special Bench concluded that the freight, telecom charges or insurance attributable to the delivery of articles or things or computer software outside India or expenditure, if any, incurred in foreign exchange in providing the technical services outside India are to be excluded both from the export turnover and from total turnover which are numerator and denominator respectively in the formula. The appeals filed by the department were dismissed.

### **Our Comments**

Since some of the terms are not defined in the formula for computation of tax holiday benefits, there has been considerable litigation on these aspects. The Special Bench upholds a very important doctrine of parity while computing tax holiday benefits under section 10A and 10 B of the Act. Thus it will provide a relief to many exporters especially the information and technology sector. Further this is a Special Bench decision and it is binding on all other Tribunal benches in India.

This decision will put at rest such controversy and will provide more clarity and certainty to taxpayers.

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