

TAX FLASH NEWS

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Section 10AA benefit on export by SEZ units is available on commercial profits before claim of tax depreciation and investment allowance

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Reliance Industries Ltd.¹ (the taxpayer) dealt with the issue of grant of deduction under Section 10AA of the Income-tax Act, 1961 (the Act) on 'profits and gains' earned by units located in a Special Economic Zone (SEZ) without deducting tax depreciation and investment allowance under the Act (i.e. commercial profits). The Tribunal held that the taxpayer is eligible to claim deduction under Section 10AA with reference to commercial profits (i.e. without deducting tax depreciation and investment allowance under the Act).

Facts of the case

The taxpayer is engaged in the business of oil and gas exploration, refining of crude oil, manufacturing of and trading in petrochemicals etc. The taxpayer had set up a refinery (eligible unit) within an SEZ for refining of mineral oil, from which the taxpayer earned export turnover. During the relevant assessment year (AY), the taxpayer claimed deduction under Section 10AA. It was allowed by the tax department with reference to the income computed under the business head of the SEZ unit after considering tax depreciation and investment allowance under the Act.

However, before the Tribunal, the taxpayer relied on the three-judges Bench decision of the Supreme Court in the case of Vijay Industries², and raised an additional ground contending that the deduction should have been granted with respect to commercial profits of the SEZ unit (i.e., without claim of tax depreciation and investment allowance under the Act).

Tribunal's decision

The Supreme Court in the case of Vijay Industries observed that the scheme of the Act itself differentiates between the concept of 'Income' under the Act and 'profits and gains'. On reference to 'income-linked deduction requires computation of 'income' after allowance of all deductions and allowances wherein, in case of deduction linked to 'profits and gains', deduction can be allowed with reference to commercial profits without considering the tax depreciation and other allowances.

The language of Section 10AA and Section 80HH is similar in so much as both the sections allows deduction of a certain percentage of 'profits and gains derived from' eligible activity and, hence, the ratio of the Supreme Court in the case of Vijay Industries was applicable to the taxpayer.

The tax department's contention, that the Supreme Court decision in the case of Vijay Industries is not applicable in the present case since it dealt with an assessment year when Section 80AB was not in force and there was change in law thereafter due to the introduction of Section 80AB, was not correct.

Provisions of Section 80AB, even though made applicable to Deduction Chapter, have not been extended to Section 10AA. Accordingly, the ratio of the Supreme Court decision can be invoked to interpret the phrase 'profits and gains' under Section 10AA.

The provisions of Section 80-IA relied on by the tax department was also not correct since such provisions deal with a case where deduction is permitted at the stage of computing total income after taking into consideration all deductions and allowances as against under Section 10AA (prior to the insertion of Explanation thereof with effect from AY 2018-19) deduction is available at the interior stage.

¹ Reliance Industries Ltd. v. ACIT (ITA No. 7299/Mum/2017) – Taxsutra.com
Note: The Tribunal dealt with several other issues in this decision. However, this flash news deals with the issue of allowability of deduction under Section 10AA on commercial profits.

² Vijay Industries v. CIT (Civil Appeal No.1581/1582 of 2005) (SC)

Explanation to Section 10AA has prospective effect from 1 April 2018 and cannot be invoked for determining the amount of deduction in the present case which pertains to an earlier year.

After the well-reasoned Supreme Court decision in the case of Vijay Industries on the issue, there cannot be any scope for ambiguity in interpreting the words 'profits and gains'. Accordingly, the Tribunal held that the taxpayer is eligible to claim deduction under Section 10AA with reference to commercial profits (i.e. without deducting tax depreciation and investment allowance).

Our comments

The claim of deduction under Section 10AA with reference to commercial profits (i.e. without deducting tax depreciation and investment allowance) has been a matter of debate before the Courts.

The three-judges bench of the Supreme Court in the case of Vijay Industries, held that the deduction under Section 80HH is allowed on the commercial profit.

The Mumbai Tribunal, in the instant case, relying on the decision of the Supreme Court in the case of Vijay Industries observed that the language of provisions of Section 80HH and Section 10AA are similar and therefore the deduction under Section 10AA is available on commercial profits.

Based on this decision, it would be interesting to explore possibility to claim deduction under Section 10AA on the commercial profits calculated before claiming tax depreciation and investment allowance for the relevant applicable AYs.



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