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TAX FLASH NEWS

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Section 10A being a deduction provision, the gross total income of the eligible undertaking should be computed before the aggregation of income and the provisions for set-off and carry forward - Supreme Court

Background

Recently, the Supreme Court of India in the case of Yokogawa India Ltd.[1] (the taxpayer) held that the provisions of Section 10A the Income-tax Act, 1961 (the Act), as amended[2], is a provision for deduction and would be considered while computing the gross total income of the eligible undertaking under Chapter IV of the Act and not at the stage of computation of the total income under Chapter VI i.e. before aggregation of the incomes under other heads and the provisions for set-off and carry forward.

The introduction of the word 'deduction' in Section 10A of the Act by the amendment, and the scope of the deductions contemplated by Section 10A, indicate that the nature of the provision has altered from one providing for exemption to one providing for deductions.

The deduction of the eligible undertaking has to be made independently and immediately after the stage of determination of its profits and gains.

Facts of the case

- The tax department had filed special leave petitions before the Supreme Court for the determination of the meaning and effect of the provisions of Section 10A of the Act.
- The tax department contended that ex facie, from the language appearing in Section 10A, it is clear that Section 10A of the Act, as amended by Finance Act, 2000 provides for deductions from the gross total income, notwithstanding the use of the words 'total income' in it. Exemptions provided for under the old Section 10A have been discontinued by the legislature. Where the purport and effect of the statute is clear from the language used there is no scope to turn to chapter notes or the marginal notes[3]. By virtue of the amendment, the deductions under Section 10A are required to be made and allowed at the stage of computation of total income under Chapter VI of the Act.
- Whereas, the taxpayer contended that the reference to the total income of the undertaking, referred to in several sub- sections of Section 10A, would indicate that the total income referred to in Section 2(45) has no application to the computation under Section 10A and the reference therein is only to the total income of the eligible unit/undertaking. Though heterogeneous elements exist in Section 10A, the provision is an exemption provision. Alternatively, even if Section 10A is understood to be providing for deductions, the stage of such deductions would be immediately after computation of profits and gains of business and before the aggregate of incomes under different heads of other loss making eligible units or non-eligible units of the assessee are taken into account.

[1] CIT v. Yokogawa India Ltd. [Civil Appeal No. 8498 OF 2013 and others] – Taxsutra.com

[2] By the Finance Act, 2000, w.e.f. 1 April 2001

[3] Tata Power Co. Ltd. v. Reliance Energy Ltd. [Civil Appeal nos. 3510 - 3511 OF 2008, dated 06 May 2009]

The Supreme Court's decision

Section 10A provides deduction and not exemption

- The amendment of Section 10A of the Act, by the Finance Act, 2000[4], specifically uses the words 'deduction of profits and gains derived by an eligible unit …… from the total income of the assessee'.

- The true and correct purport and effect of the amended Section will have to be construed from the language used and not merely from the fact that it has been retained in Chapter III. The introduction of the word 'deduction' in Section 10A by the amendment, in the absence of any contrary material, and in view of the scope of the deductions contemplated by Section 10A, it has to be understood that the Section embodies a clear enunciation of the legislative decision to alter its nature from one providing for exemption to one providing for deductions.

- The difference between the two expressions 'exemption' and 'deduction', though broadly may appear to be the same i.e. immunity from taxation, the practical effect of it, in the light of the specific provisions contained in different parts of the Act would be wholly different.

- Sub-section 4 of Section 10A which provides for pro rata exemption, necessarily involving the deduction of the profits arising out of domestic sales, is one instance of deduction provided by the amendment. Profits of an eligible unit pertaining to domestic sales would have to enter into the computation under the head 'Profits and Gains from Business' in Chapter IV and denied the benefit of deduction.

- The provisions of sub-section 6 of Section 10A, as amended by the Finance Act of 2003, granting the benefit of adjustment of losses and unabsorbed depreciation etc. commencing from the year 2001-02 on completion of the period of tax holiday, also virtually works as a deduction, which has to be worked out at a future point of time, namely, after the expiry of period of tax holiday.

- The absence of any reference to a deduction under Section 10A in Chapter VI of the Act can be understood by acknowledging that any such reference or mention would have been a repetition of what has already been provided in Section 10A. The retention of Section 80HHC and 80HHE, despite the amendment of Section 10A, indicates that some additional benefits to eligible Section 10A units was intended by the legislature.

Deductions under Section 10A is qua the eligible undertaking

- A reading of Section 10A indicates that the deductions contemplated therein is qua the eligible undertaking of an assessee, without reference to the other eligible or non-eligible units or undertakings of the assessee. The benefit of deduction is given by the Act to the individual undertaking and resultantly flows to the assessee.

The stage of the deduction

- The specific provisions of the Act i.e. first proviso to Sections 10A(1); 10A(1A) and 10A(4), provide that the unit that is contemplated for grant of benefit of deduction is the eligible undertaking and that is also how the contemporaneous CBDT Circular[5] understood the situation. Accordingly, the stage of deduction of the profits and gains of the business of an eligible undertaking has to be made independently and, therefore, immediately after the stage of determination of its profits and gains. At that stage the aggregate of the incomes under other heads and the provisions for set-off and carry forward contained in Sections 70, 72 and 74 of the Act would be premature for application.

- The deductions under Section 10A therefore, would be prior to the commencement of the exercise to be undertaken under Chapter VI of the Act for arriving at the total income of the assessee from the gross total income.

- The expression 'total income of the assessee' in Section 10A can be understood as 'total income of the undertaking'.

[4] with effect from 1 April 2001

[5] CBDT Circular No.794, dated 9 August 2000

- The decision of this Court with regard to the provisions of Section 10A of the Act would equally be applicable to cases governed by the provisions of Section 10B, in view of the said later provision being *pari materia* with Section 10A of the Act, though governing a different situation.

Accordingly, though Section 10A, as amended, is a provision for deduction, the stage of deduction would be while computing the gross total income of the eligible undertaking under Chapter IV of the Act and not at the stage of computation of the total income under Chapter VI.

Our comments

The issue with respect to computation of gross total income where there are eligible unit profits and non-eligible unit losses, has been a subject matter of debate before the courts. There are various decisions where it has been held that Section 10A is an exemption provision and therefore, business losses will be set-off before setting-off non-eligible unit losses against eligible unit profits. However, some of the courts[6] have held that while computing the gross total income, non-eligible business losses should be first set-off against eligible unit profits, and then the business losses should be set-off. Accordingly, this controversy reached the Supreme Court.

The Supreme Court has now put an end to this issue by holding that the amendment in Section 10A has altered the nature of the provision from providing exemption to providing for deductions. Section 10A indicates that the deductions contemplated therein is qua the eligible undertaking of an assessee. The deductions under Section 10A would be prior to the commencement of the exercise to be undertaken under Chapter VI of the Act (i.e. aggregation of income and set-off of loss) for arriving at the total income of the assessee from the gross total income.

This decision is with regard to the provisions of Section 10A, however, the same may be helpful for similar issues under other provisions like Section 10B and 10AA of the Act.

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[6] CIT v. TEI Technologies (P.) Ltd. [2012] 25 taxmann.com 5 (Del), CIT v. Black and Veatch Consulting Pvt. Ltd. [TS-260-HC-2012(Bom)], CIT v. Yokogawa India Ltd., [2012] 341 ITR 385 (Kar)

www.kpmg.com/in

Ahmedabad
Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bangalore 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23 (Ist Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai
No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Delhi
Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad
8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi
Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai
Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida
6th Floor, Tower A
Advant Navis Business Park
Plot No. 07, Sector 142
Noida Express Way
Noida 201 305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune
703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3050 4000
Fax: +91 20 3050 4010

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