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## Section 10A/10B of the Act deduction available on income incidental to carrying on business of the undertaking, post amendment by Finance Act 2001

### In brief

- In the decision of Motorola India Electronics Pvt. Ltd.<sup>1</sup>, the High Court (HC) has granted section 10A/10B of Income-tax Act, 1961 (the Act) benefits on interest income in the light of the amendment to Finance Act, 2001. Post such amendment to sub-section 4 of sections 10A/10B of the Act, profits derived from the export of articles or things or computer software had to be reckoned in relation to the profit of the business of the undertaking as distinguished from the profits or gains from export of articles.

<sup>1</sup> Motorola India Electronics Pvt. Ltd. [TS-683-HC-2013(KAR)]

- Therefore, the ruling clearly distinguished the two periods, i.e. relating to pre- and post-amendment. In the post-amendment period, the words 'derived from' and 'attributable to' would no longer be relevant.

### Facts

- The taxpayer was engaged in the business of development of software, and was a 100% Export Oriented Unit entitled for benefit under sections 10A/10B of the Act.
- The taxpayer had outstanding borrowings by way of External Commercial Borrowings (ECB) for the business of Software Technology Park (STP) units.

Due to restrictions on pre-payment of such borrowings, the taxpayer had temporarily parked such funds in an Exchange Earners Foreign Currency (EEFC) account, fixed deposits and with various sister concerns as Inter Corporate Deposits (ICD).

- The taxpayer had treated the interest derived from such EEFC account / fixed deposits / ICDs as 'business income' and consequently claimed benefits under sections 10A/10B of the Act for the Assessment Years (AYs) 1998-99 and 2001-02.
- The Tax Officer (TO) denied sections 10A/10B of the Act benefit for the AY 2001-02, despite the amendment made to these sections *vide* Finance Act 2001, and this denial was further confirmed by the Commissioner of Income-tax (Appeals) (CIT(A)).
- On further appeal by the taxpayer against the CIT(A)'s order, the Income-tax Appellate Tribunal (Tribunal) appreciated the amended scope of sections 10A/10B of the Act post Finance Act 2001, and allowed exemption under sections 10A/10B of the Act for the AY 2001-02.
- The Tribunal denied sections 10A/10B of the Act exemption for AY 1998-99 on the premise that section 10A/10B(4) of the Act, before the amendment by the Finance Act 2001, restricted the exemption only to export profits.

## Issue

- Should the interest received by the taxpayer be brought to tax under the head, 'income from business' or under the head, 'income from other sources'?
- Should such interest and consideration received on sale of import entitlements be treated as part of total income for the purpose of computing exemptions under sections 10A and 10B of the Act?

## Revenue's contention

- In order to grant benefits under sections 10A / 10B of the Act, profits and gains derived from the export of articles or things or computer software had to be considered, and not the profits of the business of the undertaking.

- The word, "derived from" was narrower in connotation and covered sources not beyond the first degree. Hence, interest income earned and consideration received from sale from import entitlements could not be construed as profits and gains from export of computer software, and hence the same were liable to be taxed.
- Support and reliance was placed on an array of Supreme Court decisions such as in the case of Pandian Chemicals Ltd<sup>2</sup>, Liberty India<sup>3</sup> and Sterling Foods<sup>4</sup> etc., contending that the interest received, and consideration from, sale of import entitlements had no direct nexus with the profits and gains derived from the export of software, and therefore, the taxpayer was not eligible for exemption in respect thereof.

## Taxpayer's contention

- The interest derived from EEFC deposits / fixed deposits / ICDs and consideration received from sale of import entitlements had to be assessed as 'business income'.
- Such interest was eligible for the benefit under sections 10A/10B of the Act, as it was derived from the business of export of articles or things or computer software for the AY 1998-99.
- As for AY 2001-02, the benefit of sections 10A/10B of the Act was available on the interest income, taking cognizance of the amendment to sections 10A/10B(4) of the Act *vide* Finance Act, 2001, on the basis that it formed part of 'profit from the business of industrial undertaking', considering that the entire business of the taxpayer consisted of development and export of software.
- The taxpayer rebutted the revenue's contention that the interpretation of the word, 'derived from' has ceased to be relevant after the amendment to Finance Act 2001.

<sup>2</sup> Pandian Chemicals Ltd. v. CIT [2003] 262 ITR 278 (SC)

<sup>3</sup> Liberty India v. CIT [2009] 317 ITR 218 (SC)

<sup>4</sup> CIT v. Sterling Foods [1999] 237 ITR 579 (SC)

## High Court ruling

- So far as the judgements relied on by the counsel for the revenue authorities were concerned, the HC observed that all the decisions were rendered prior to the 2001 amendment and further, they were rendered in the context of section 80HHC of the Act.
- Noting the pre-amendment provisions of sections 10A/10B of the Act and the Revenue's reliance on various rulings, the HC held that the Tribunal's order declining sections 10A/10B of the Act benefit for the AY 1998-99 was justified.
- Post the amendment, what was exempted was not merely the profits and gains from the export of articles, but also the income from the business of the undertaking.
- There was a direct nexus between interest income earned and the income from the business of the undertaking. The HC clarified that though such income did not partake the character of profit and gains from the sale of any article, it was income derived from the consideration realised by export of articles. These incomes were therefore taxable under 'profits and gains from business or profession'.

- The HC examined the scope of the amendment *vide* Finance Act, 2001 and held that the 'profits of the business of the undertaking' referred to in the amended sections 10A/10B(4) of the Act included the profits and gains from export of the articles as well as all other incidental incomes derived from the business of the undertaking.
- The Tribunal's order allowing sections 10A/10B of the Act benefit for the AY 2001-02 was justified in the light of the amendment to sections 10A/10B of the Act by Finance Act 2001.

## PwC's observation

- This is a welcome ruling which concludes that 'profits of business of undertaking' as contemplated in the amended sections 10A/10B of the Act is distinguished from the provisions that existed before the amendment, where the differentiation of 'derived from' and 'attributable to' was predominant.
- This ruling would bring reprieve to ongoing litigation on this issue, particularly within the jurisdiction of Karnataka HC. Therefore, sections 10A/10B of the Act as amended do have a wider scope.

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