

Direct Tax Alert

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Mumbai Tribunal allows deduction under section 10AA basis commercial profits and not tax profits

Deduction under section 10AA can be computed basis the 'gross profit and gains' (i.e. commercial profits) of the SEZ unit and not basis the income computed under the heads 'profits and gains on business on profession' (i.e. taxable profits). Further simultaneous deduction under section 80-IB(9) can be claimed by the tax payer for the balance profits which are not allowed under section 10AA of the Act. The Tribunal further allows deduction in respect of CSR expenses.

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal ('ITAT'), in the case of *Reliance Industries Limited v. ACIT*¹ ('the Assessee') has *inter alia* decided on several issues like taxability of sales tax incentive, deduction under section 10AA of the Income-tax Act, 1961 ('the Act'), disallowance under section 14A, transfer pricing adjustments, etc.. This alert summarizes certain key issues involved in the case and the decision of the ITAT on those issues.

Issue 1 - Whether simultaneous deduction permissible under section 10AA of the Act and under section 80-IB(9) of the Act.

Facts of the case

- The Assessee had a Refinery SEZ unit in Moti Khavdi. The profits and gains of the Refinery SEZ unit were eligible for deduction under section 10AA of the Act. Out of the total refinery profits of approx. Rs. 7,530 crores, the Assessee had claimed a deduction of approx. Rs. 6,832 crores under section 10AA of the Act.

¹ TS-588-ITAT-2020(Mum)



- The balance profit of Rs. 698 crores was claimed as a deduction by the Assessee under section 80-IB(9) of the Act since the Refinery SEZ unit also complied with the conditions prescribed under section 80-IB of the Act.
- The assessing officer disallowed deduction under section 80-IB(9) of the Act by contending that the entire profit of the unit has already been considered while allowing deduction under section 10AA of the Act. Hence, no deduction was admissible under section 80-IB(9) of the Act in view of the provisions of section 80A(4) of the Act. The CIT(A) upheld the action of the assessing officer.

Ruling of the ITAT

- The ITAT followed its earlier order wherein it had decided the issue in favour of the Assessee.
- In its earlier order, the ITAT interpreted the scope of section 80A(4) of the Act which restricts profits allowed as a deduction under section 10A, 10AA, 10B, 10BA or any provisions under Heading C of Chapter VI-A from being claimed as a deduction under any other provisions of the Act.
- The ITAT observed that the expressions 'any amount of profit', 'claimed and allowed', and 'deduction in respect of and to the extent of such profits' are the key expressions for interpreting section 80A(4) of the Act.
- Having regard to the aforesaid expressions, the ITAT observed that the restriction contained in section 80A(4) is applicable only to the extent of the profit that has actually been allowed as a deduction under section 10AA of the Act.
- In the instant case, the profits claimed as deduction under section 80-IB(9) have not been allowed as deduction under section 10AA. Consequently, the provisions of section 80A(4) will not apply and the deduction under section 80-IB(9) is to be allowed on such profits.

Issue 2 – Whether deduction under section 10AA can be claimed on gross or commercial profits (i.e. without considering tax depreciation and investment allowance)

Facts of the case

- During the ITAT proceedings, the Assessee raised an additional ground that the deduction under section 10AA of the Act should be **computed on the basis of 'gross profit and gains'** of the Refinery SEZ unit and **not on income computed under the head 'profits and gains on business on profession'**.
- The additional ground was raised by the Assessee basis the decision of the Supreme Court in the case of *Vijay Industries v. CIT*².
- In the aforesaid case, the Supreme Court interpreted the term 'profits and gains' to be distinct from the term 'income' and wider in scope. Thus, the Supreme Court observed that the deduction under section 80HH of the Act would be computed basis the gross profits and gains i.e. before computing the taxable income as per the provisions contained in section 30 to 43D of the Act.
- The Supreme Court further observed that the provisions of section 80AB³ of the Act restricting the deduction available under Heading C of Chapter VI-A of the Act to the extent of income computed in accordance with the provisions of the Act are not clarificatory and hence, will apply prospectively.

Arguments by the Assessee:

- The words 'profits and gains' contained in section 80HH are *pari materia* with the wordings of section 10AA of the Act. As such, the ratio of the Supreme Court in the case of *Vijay Industries (supra)* will apply to section 10AA of the Act as well.
- Decision of the Supreme Court in the case of *Plastiblends India Limited v. ACIT*⁴ is not applicable as it dealt with section 80-IA which

2 [2019] 103 taxmann.com 454 (SC)

3 Inserted by the Finance (No. 2) Act 1980 w.e.f. 1 April 1981

4 [2017] 398 ITR 568 (SC)



falls under Chapter VI-A and therefore covered by the provisions of section 80AB. Section 80AB is not applicable to section 10AA. In any case, deduction under section 10AA (prior to the amendment made by Finance Act 2017 by way of insertion of Explanation⁵) was to be given at the stage of computing the gross total income of the eligible undertaking under Chapter IV of the Act i.e. 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.

- Wherever the legislature wanted to allow a deduction as a percentage or fraction of income computed under the head profits and gains of business or profession, it has specifically provided for the same e.g. deduction under section 33ABA. In the absence of a similar provision in section 10AA, the term profit and gains for the purpose of section 10AA will mean gross profits.
- Provisions of section 80AB are not *pari materia* with the Explanation to section 10AA(1) of Act. As such, the Explanation cannot be considered as restricting the deduction under section 10AA to income as computed under the provisions of the Act. In any case, the Explanation to section 10AA(1) is effective from 1 April 2018 and will have application from AY 2018-19 onwards.
- The Assessee had also made a without prejudice submission to the above arguments stating that term profit and gains is to be determined based on commercial principles i.e. by considering the depreciation under the Companies Act, 1956 instead of depreciation under section 32 of the Act.

Arguments by the tax department

- Provisions of section 80HH of the Act and section 10AA of the Act are not *pari materia*. Section 10AA deals with profit and gains *derived* from an undertaking and not from 'profits and gains' as is the case with section 80HH. Consequently, the ratio of the Supreme Court decision in *Vijay Industries (supra)* is not applicable in the context of section 10AA.

- The decision of the Supreme court in the case of *Vijay Industries (supra)* dealt with assessment years prior to introduction to section 80AB. Post introduction of section 80AB i.e. from 1 April 1981, deduction under section 80HH is restricted to income determined in accordance with the provisions of the Act. Thus, even if a parallel reading is sought between section 80HH and section 10AA, the decision is not applicable for AY 2013-14.
- The Supreme Court in the case of *Plastiblends India Limited (supra)* in the context of section 80-IA has held that the deduction under section 80-IA has to be computed after considering the deductions under section 30 to 43D of the Act. The provisions of section 10AA are *pari materia* to section 80-IA. Therefore, the decision of *Plastiblends India Limited (supra)* and not *Vijay Industries (supra)* will apply in the context of section 10AA.
- Explanation to section 10AA(1)⁶ being clarificatory in nature will have retrospective effect. The Explanation restricts the deduction under section 10AA to the total income computed as per the provisions of the Act.
- Section 10AA is an exemption provision and as such needs to be interpreted strictly and in case of any ambiguity the interpretation needs to be in favour of the Revenue.

Ruling of the ITAT

- The Supreme Court in the case of *Vijay Industries (supra)* has brought out the difference between **income** taxable under the head profits and gains of business or profession and **profits and gains** with respect to which deduction is to be allowed. The latter i.e. the profits and gains are to be computed without deduction of depreciation and investment allowance as per the Act.
- The language of section 80HH and section 10AA is *pari materia*. Both the sections provide that in computing the total income of the assessee deduction shall be allowed at certain percentage of profit and gains derived and hence, the contention of the Assessee basis

⁵ Explanation to section 10AA(1) of the Act

⁶ Inserted by Finance Act 2017 with effect from 1 April 2018



the decision of the Supreme Court in the case of *Vijay Industries (supra)* is to be accepted.

- Although the provisions of section 80AB and the Explanation to section 10AA(1) are *pari materia*, the Supreme Court in case of *Vijay Industries (supra)* has held that section of 80AB will have prospective applicability. Accordingly, the Explanation to section 10AA(1) will also apply prospectively. Hence the Explanation cannot be invoked for the AY 2013-14.
- The decision of *Plastiblends India Limited (supra)* is not applicable as it dealt with deduction under section 80-IA of the Act which forms part of Chapter VI-A of the Act and the same was subject to section 80AB. The present case of deduction is under section 10AA of the Act to which the provisions of section 80AB are not applicable.
- Section 10AA is not an exemption provision but a deduction provision as confirmed by the Supreme court in the case of *CIT v. Yokogawa India Ltd*⁷. However, the deduction is to be given at the stage of computing the gross total income of the eligible undertaking under Chapter IV of the Act (prior to the amendment made by Finance Act 2017)
- Post the elaborate and well-reasoned order of the Supreme Court in the case of *Vijay Industries (supra)*, there is no ambiguity in the interpretation of the term 'profits and gains'. As such, the argument of the Revenue that the interpretation has to be done strictly and in case of any ambiguity, the interpretation has to be in favour of the Revenue does not hold good.

Issue 3 – Deductibility of expenses incurred in relation to Corporate Social Responsibility ('CSR')

Facts of the case

- The Assessee had incurred CSR expenses by way of contribution to certain trusts. The expense was disallowed under section 37(1) by the assessing officer and the CIT(A) on the ground that it has not been laid out wholly and exclusively for business.

Ruling of the ITAT

- ITAT relied on the ruling in the case of *ACIT v. Jindal Power Ltd*⁸ to hold that CSR expenses are allowable as deduction under section 37(1) of the Act and that the Explanation to section 37(1) is effective from 1 April 2015.
- The ITAT observed that no contrary decision has been brought on record by the Revenue. Further, the argument that the CSR expenses are to be disallowed since they have been incurred through trusts is also not sustainable since there is no bar on carrying on CSR activities through trusts.
- Also, no case has been made out by the assessing officer that the CSR expenses are not covered by section 135 of the Companies Act, 2013 or are not genuine. The relevant documents have been verified by the assessing officer and have found to be correct and thus the claim for CSR expense is to be allowed.

Dhruva Comments:

The decision of the ITAT allowing deduction under section 10AA based on gross profits is path breaking. Taxpayers should certainly evaluate the possibility of making a claim for additional deduction under section 10AA of the Act (especially for years prior to AY 2018-19). For AY 2018-19 and onwards there may still be some possibility to argue that despite the Explanation to section 10AA(1) claim of deduction on the basis of commercial profits could still be merited.

⁷ [2017] 77 taxmann.com 41 (SC)

⁸ [2016] 70 taxmann.com 389 (Raipur - Trib.)



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