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Sharp Insights

In HCL Technologies Ltd, Supreme Court explains that "total turnover" for purpose of section 10A, is sum of export turnover as well as domestic turnover

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In this issue:

Facts of the case

- HCL Technologies Limited (the Respondent / the Company) is engaged in the business of development and export of computer software and also in rendering technical services. The Company is eligible to claim benefit under section 10A of the Income tax Act, 1961, (the Act).
- For the Assessment Year 2004-05, the Company declared the gross income of INR 2,670,176,529 and claimed deduction under section 10A of the Act to the tune of INR 2,734,539,379, thus claiming a net loss of INR 64,362,850.
- The case was selected for scrutiny and the Assessing Officer, vide assessment order dated 28 December 2006, held that the software development charges as claimed by the Respondent, are in the nature of expenses incurred for providing technical services outside India and thus shall be reduced from the export turnover as per the provisions of section 10A of the Act.
- However, the Assessing Officer was of the view that the expenses incurred were not entirely for providing technical services outside India and some element of the expenses were also incurred for the purpose of software development. In the absence of any bifurcation, the Assessing Officer estimated that expenses to the extent of 40% were incurred in connection with software development and the remaining 60% were for providing technical services by the Respondent, in foreign exchange, outside India.
- The CIT (A) partly allowed the appeal filed by the Respondent and estimated that expenses to the extent of 10% were incurred by the Respondent towards technical services provided outside India, as against the 60% estimated by the Assessing Officer.
- ITAT reversed the order of the CIT (A) and admitted the appeal filed by the Respondent. Being aggrieved, the Revenue authorities filed an appeal before High Court. The High Court upheld the order of the ITAT and dismissed the appeal filed by the Revenue Authorities.
- Aggrieved by the order of the High Court, the Revenue Authorities filed an appeal before the Supreme Court.

Issues under consideration

- Whether expenses incurred in foreign exchange for providing technical services outside India, are to be excluded from total turnover for the purpose of computing relief under section 10A?

Ruling of the Supreme Court

- It is an undisputed fact that neither section 10A nor section 2 of the Act defines the term “total turnover”. However, the term is given in clause (ba) of the Explanation to section 80HHC of the Act, which defines the meaning of total turnover, but does not

categorically provide for reduction for expenses incurred in foreign exchange for providing technical services outside India.

- Section 10A of the Act is a special beneficial provision of the Act and the purpose of the deduction under such section is to encourage and boost new business undertakings situated in the Free Trade Zone of India.
- The definition of total turnover given under sections 80HHC and 80HHE of the Act cannot be adopted for the purposes of section 10A of the Act, as the technical meaning of total turnover, which does not envisage the reduction of any expenses from the total amount, is not to be taken into consideration for computing deduction under section 10A.
- As the term total turnover has been defined in the Explanation to section 80HHC and 80HHE, wherein it has been clearly stated that "for the purpose of this section only", the said definition would be applicable only for the purpose of those sections and not for the purposes of section 10A.
- When the meaning of export turnover is clear there is no necessity of importing the meaning of total turnover from other provisions of the Act. If denominator includes certain amount of a certain type, which the numerator does not include, the formula would render undesirable results.
- Therefore, what is excluded from 'export turnover' must also be excluded from 'total turnover', since 'export turnover' is the component of 'total turnover'. Any other interpretation would run counter to the legislative intent and would be impermissible.
- Accordingly, the formula for computation of the deduction under section 10A of the Act would be as follows:

$$\text{Export Profit} = \text{total profit of the business} \times \frac{\text{Export turnover as defined in Explanation 2(iv) of section 10A of the Act}}{\text{Export turnover of as defined in Explanation 2(iv) of the Act + domestic sales proceeds}}$$

Conclusion

- The Supreme Court has laid down that it is the cardinal principle of law that the interpretation by the Court shall be done in such a way that the intention of the legislature shall prevail and no injustice is occurred to the parties. The rule of harmonious construction is the thumb rule to interpretation of any statue.
- As such, if the deductions on freight, telecommunication and insurance, attributable to the delivery of computer software under section 10A of the Act, are allowed only in export turnover but not from the total turnover then, it would give rise to inadvertent, unlawful, meaningless and illogical result, which would cause grave injustice to the taxpayer, which could never be the intention of the legislature.
- This landmark judgement of the Supreme Court lays to rest the controversy surrounding the treatment of expenses from total turnover, while computing the deduction under section 10A of the Act. Going forward, the judgement should bring relief to several cases which were pending resolution for want of clarity.

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