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CIT vs HCL Technologies Ltd

The Supreme Court issues a landmark decision clarifying definition of 'Total Turnover" for computing quantum of deduction u/s 10A and 10AA, and giving substantial relief to Export Oriented Units and SEZ units exporting goods and services outside India.

Background:

- To promote exports from India, the Government had earlier provided for a tax holiday upto 100% of profits to such units during initial 5-15 years of operations of such units, in respect of their export revenues. The idea was to incentivize the Indian companies to produce such goods and services, which could earn foreign currency income for the Country and improve the balance of payments situation of the country.

- Quantum of such income tax deduction was to be computed using a formula, viz: (Profit of Undertaking) X (Export Turnover)/ (Total Turnover). This formula/ mechanism was to ensure that income tax deduction is allowed only in respect of Export Profits and not in respect of profits from Domestic Sales.

- Further, while calculating the eligible Export Turnover (i.e. numerator in above formula), certain expenditure were also specifically required to be excluded such as freight, telecommunication and insurance attributable to the delivery of software outside India and expenses incurred in foreign currency for providing technical services outside India.

- However, there was no corresponding exclusion in computing "Total Turnover" (i.e. denominator in above formula) and in fact, term "Total Turnover" was not even defined under relevant sections 10A and 10AA of the Act.

Facts of the Case under Litigation:

- In a large batch of matters involving HCL Technologies Limited and many other similar companies engaged in the business of development and export of computer software and related services, the Assessees had incurred certain expenditure in the nature of freight, telecommunication and insurance attributable to the delivery of software outside India and expenses incurred in foreign currency for providing technical services outside India.

- While such expenses were required to be excluded from "Export Turnover" as per definition of "Export Turnover" as prescribed under the Act, there was no clarity on excluding these expenses from definition of 'Total Turnover'.

- This above situation gave rise to a dispute/ litigation between taxpayers and the income tax department. While the income tax department contended that in absence of a specific exclusion from Total Turnover, above-mentioned expenses could not be excluded from "Total Turnover", even though these were excluded from Export Turnover.

- However, the tax payers claimed that such expenses, if deducted from Export Turnover were also required to be deducted from Total Turnover, else it will create an anomaly. For example, in case of EOUs and SEZ units, which export 100% of their goods and services will not be able to claim a deduction of 100% of their profits due to difference in definition of Export Turnover and Total Turnover (as adopted by income tax department), despite deriving 100% of their revenues from Exports.

Supreme Court's judgment:

- Taking a view beneficial to the taxpayers, the Supreme Court held that it would be absurd to include a component in the denominator when the same has been specifically excluded from the numerator by the Act. It would not give the correct results and make the formula unworkable.

- Accordingly, it has been held that expenses incurred rendering services outside India will be excluded from 'total turnover' as well, since the same has been specifically excluded from the definition of export turnover. No reference would be made to any other provision in the Act as the meaning of the term gets cleared by referring to the complete section.

NANGIA'S TAKE

"In a welcome ruling, the Supreme Court has adopted an interpretation beneficial for taxpayers and held that despite being no specific definition of 'Total Turnover' for section 10A and 10AA of the Income Tax Act, the term has to be interpreted in a manner beneficial to the taxpayer and also in a manner, which appears more logical and reasonable. The Supreme Court has held that interpretation as adopted by the Income tax department would lead to absurd results and will make the formula for computing tax deduction unworkable".

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