**IN THE INCOME TAX APPELLATE TRIBUNAL**
**LUCKNOW A BENCH, LUCKNOW**

**Before Shri Sunil K Yadav (Judicial Member),**
**and Shri Pramod Kumar (Accountant Member)**

ITA No. 363/Luck /2010, 435 to 437/Luck/2011
Assessment year: 2006-07, 05-06, 04-05 and 03-04

***Arvind Footwear Pvt Ltd*** ***……Appellant***
*E 56, Panki Industrial Area, Site III*
*Kanpur 208 022[PAN: AABCP1870B]*

***Vs.***

***Deputy Commissioner of Income Tax***
***Range 6, Kanpur*** ***……Respondent***

**Appearances:**
Abhinav Mehrotra, *for the appellant*
Ranu Biswas , *for the respondent*

Date of hearing : June 6, 2013
Date of pronouncement : August 27, 2013

**O R D E R**

**Per Pramod Kumar :**

1. These four appeals pertain to the same assessee, involve a common issue arising out of same set of facts, and were heard together. As a matter of convenience, therefore, we will dispose of all the four appeals together by way of this consolidated order.

2. However, for the sake of convenience, we will take up the facts of ITA No. 363/Luck/2010 which pertains to the assessment year 2006-07.

3. In this appeal, the assessee appellant has challenged correctness of learned Commissioner (Appeals)'s order dated 4th March 2010, in the matter of assessment under section 143(3) of the Income Tax Act, 1961, for the assessment year 2006-07.

4. The assessee has raised as many as seven grounds of appeal. However, as learned representatives fairly agree, the two issues really requiring our adjudication is whether or not the learned Commissioner (Appeals) was justified in declining deduction under section 80 IB of the Act in respect of duty drawback received aggregating of Rs 1,53,94,403, and whether or not the learned Commissioner (Appeals) was justified in upholding the disallowance of the expenses to the tune of Rs 36,000 under section 14A of the Act. In view of the smallness of the amount, learned counsel did not really press the second issue beyond stating the facts and leaving the issue to us.

5. So far as the first issue is concerned, the relevant material facts are like this. The assessee before us is engaged in the business of manufacturing and export of footwear. On 21st January 2006, the assessee filed a return of income disclosing an income of Rs 1,21,94,653. This return was subjected to scrutiny assessment proceedings, during which it was, inter alia, noticed that the assessee had claimed deduction under section 80 IB in respect of entire business profits, including duty drawback receipts amounting to Rs 1,53,94,403. It was in this backdrop that the assessee was required to show cause as to why the duty drawback receipt not be excluded from the computation of deduction under section 80 IB, as it was, in the opinion of the Assessing Officer, not in the nature of business income derived from industrial undertaking. In response to this requisition, it was mainly contended by the assessee that the duty drawback refund is nothing but a refund of customs and central excise duty on the inputs used in manufacturing of its products. Elaborate submissions, on this aspect of the matter, were made by the assessee. Reliance was also placed judicial precedents in the cases of **CIT Vs Madras Motors Ltd (257 ITR 60)**, **CIT Vs Indian Gellative and Commercials Ltd (272 ITR 284**) and **CIT Vs Elteck SGS Pvt Ltd (300 ITR 6).** None of these submissions, however, impressed the Assessing Officer. He was of the view that deduction under section 80 IB could be allowed only in respect of the profits from activities which are

derived from industrial undertaking. It was also observed that "the deduction under section 80 IB could not be allowed on the amount of duty drawback in view of the fact that the duty drawback was received on account of export promotion scheme of the Government of India, and not due to any manufacturing or industrial activity of industrial unit established in a prescribed area". The Assessing Officer also referred to, and relied upon, Hon'ble Delhi High Court's judgment in the case of CIT Vs Ritesh Industries (274 ITR 324) in support of the proposition that duty drawback is not a profit derived from industrial activity, and, therefore, cannot be treated as eligible profit for allowing deduction under section 80 IB. It was in this backdrop that the Assessing Officer declined deduction in respect of the duty drawback received by the assessee. As a result of the stand so taken by the Assessing Officer, the deduction of Rs 50,74,656 claimed by the assessee under section 80 IB, the deduction was actually allowed at Rs 4,56,335. Aggrieved, assessee carried the matter in appeal before the CIT(A) but without any success. Learned CIT(A) confirmed the action of the Assessing Officer by a one sentence order which said "**This issue is squarely covered against the assessee by the decision of Hon'ble Supreme Court's order in the case of Liberty India Vs CIT 317 ITR 218** *(and)* **thus the addition/ disallowance made by the AO is confirmed**". The assessee is not satisfied, and is in further appeal before us.

6. Learned counsel for the assessee has laid a lot of emphasis on the nature of duty drawback and contended that the duty drawback receipts actually end up subsidizing the cost of production inasmuch as these receipts represent refund of excise duty and custom duty on the inputs used in products exported. It is contended that the duty drawback receipts, being integral part of the realizations on exports, are inherent part of the overall profits and, therefore, these receipts cannot be considered on standalone basis. It is submitted that on the facts of this case, particularly as duty drawback receipts are as much as almost 7.5% of turnover, and as, but for this duty drawback

receipt, there will be virtually no profits or commercial sense of running the industrial undertaking, it cannot be said that duty drawback receipts are incidental receipts or ancillary profits not derived from industrial undertaking. It is then submitted that since duty drawback receipts are *de facto* refund of excise duty and custom duty paid, and following the principle laid down by Hon'ble Delhi High Court in the case of **CIT Vs Dharmpal Premchand Ltd (317 ITR 353)**, such a refund of duties is eligible for deduction under section 80 IB. Learned counsel submits Hon'ble Supreme Court has dismissed an SLP against this judgment of Hon'ble Delhi High Court, and, as such, **Liberty India decision** is to be read in harmony with the **Dharmpal Premchand decision**. Our attention is also invited to the order dated 29th April 2011 passed by a coordinate bench in the case of **J K Aluminum Co. Vs ITO**, wherein, on the same lines, refund of excise duty is held to be eligible for deduction under section 80 IB. Learned counsel distinguishes **Liberty India decision** *(supra)* on the ground that at present we are dealing with a refund of duties, and, in support of this contention, he invites our attention to copies of several purchase invoice, which were placed before us in the paperbook, disclosing separate charges for excise duty paid on purchases. It is his contention that the duty drawback receipt is nothing but refund of these, and other, duty payments. Learned counsel submits that the present case is distinct to the extent separate payments of excise duty has been demonstrated by the assessee. Without prejudice, he contends that, in any event, duty drawback receipts are includible in the computation of deduction under section 80 IB at least to the extent of these refunds. Learned counsel contends that in today's highly competitive international market, duty drawback is integral part of the export pricing of products and it cannot be seen as standalone incentive for exports. He submits that in any many cases overall profits of an exporter is even less than duty drawback receipt, and it cannot, therefore, be said that the duty drawback receipts are excluded in computation of export prices. Once it is an accepted position that duty drawback receipts are taken into account in computation of export prices, as is his claim, the duty drawback receipts

cannot but be viewed as related to profits derived by the undertaking as first degree source. On the strength of these submissions, it is contended that deduction under section 80 IB must take into account the duty drawback receipts as well. Learned Departmental Representative, on the other hand, submits that this issue is no longer *res integra*, as Hon'ble Supreme Court, in **Liberty India's** case *(supra)*, have categorically held that duty drawback cannot be taken into account in computation of deduction admissible under section 80 IB. Our attention is also invited to Hon'ble Gauhati High Court's judgment in the case of **CIT Vs Meghalaya Steels Ltd (332 ITR 91)** wherein it rise held that even transport subsidy and interest subsidy cannot be said to be 'derived from industrial undertaking', and, accordingly, these receipts are not eligible for deduction under section 80 IB. She submits that learned counsel's erudite arguments, even if these are taken as correct on the first principles, are of no avail at this stage. She further submits that it is not a case of refund of duties but rather a case of payment of export incentive, by whatever name called, for encouraging the exports and thus contributing to augmentation of foreign exchange reserves. An export incentive, according to the learned Departmental Representative, cannot be said to related, with first degree nexus, to the 'profits derived by the undertaking'. We are thus urged to confirm the action of the authorities below and decline to interfere in the matter.

7. Learned counsel indeed has an uphill task. No matter how convincing his argument seem to be on the first principles, and no matter how strong a conceptual support he can canvass for his claim, he has judicial precedents, including from the highest judicial forum in this country, which may dissuade many, and must have dissuaded many, from even attempting to argue in support of this ambitious claim. Let us, therefore, begun by examining these judicial precedents and appreciate what has been said, and much more important than that in what context it has been so said, in these judicial precedents.

8. In the case of **CIT Vs Sterling Foods (237 ITR 579),** Hon'ble Supreme Court was *in seisin* of a situation in which the assessee, engaged in the business of processing and exporting prawns and other sea food, "earned some import entitlements granted by the Central Government under an export promotion scheme". The assessee was entitled to use the import entitlements itself or sell the same to others. It sold the import entitlements that it had earned to others. Its total income for the relevant assessment years included the sale proceeds of such import entitlements, and it claimed relief under section 80 HH in respect of the import entitlements on such import entitlements. It was in this backdrop that the question which fell for adjudication before Their Lordships was whether the income derived by the assessee on sale of these import entitlements was "profit and gain derived from its industrial undertaking of processing sea food". Their Lordships held that the sale proceeds on import entitlement could not be said to be derived from the industrial undertaking, and, while holding so, observed as follows:

> We do not think that the source of the import entitlements can be said to be the industrial undertaking of the assessee. The source of the import entitlements can, in the circumstances, only be said to be the Export Promotion Scheme of the Central Government whereunder the export entitlements become available, **There must be, for the application of the words "derived from", a direct nexus between the profits and gains and the industrial undertaking. In the instant case, the nexus is not direct but only incidental.** The industrial undertaking exports processed sea food. By reason of such export, the Export Promotion Scheme applies. Thereunder, the assessee is entitled to import entitlements, which it can sell. The sale consideration therefrom cannot, in our view, be held to constitute a profit and gain derived from the assessee's industrial undertaking.

9. In the case of **Liberty India Vs CIT (293 ITR 520),** the question which came up for adjudication before Hon'ble Punjab & Haryana High Court was whether or not deduction under section 80 IB was righty declined, in respect of DEPB and duty drawback, by the Tribunal. Their Lordships held that deduction under section 80 IB was not admissible in respect of the DEPB and duty drawback as following the reasoning adopted by Hon'ble Supreme

Court in **Sterling Food's case** *(supra)*, which has been reproduced above, "**income of the assessee from duty drawback cannot be held to be 'income derived from' specified business**". The efforts of the assessee to distinguish the two situations, i.e. in the case of Sterling Foods and in the case of Liberty India, did not yield any results, as Their Lordships further observed that, "**Distinction sought to be made by learned counsel for the assessee, in income derived from duty drawback and sale of import entitlements, cannot be accepted as relevant distinction as core question before the Court was that such income was derived from specified business, which reasoning is fully applicable to the present situation**". On the matter being carried in further appeal, Hon'ble Supreme Court, speaking through Hon'ble Justice S H Kapadia for the division bench (in the case of **Liberty India Vs CIT 317 ITR 218**) also confirmed this stand and observed as follows:

> …….The words "derived from" is narrower in connotation as compared to the words "attributable to". **In other words, by using the expression "derived from", Parliament intended to cover sources not beyond the first degree. In the present batch of cases, the controversy which arises for determination is: whether the DEPB credit/ Duty drawback receipt comes within the first degree sources?** According to the assessee(s), DEPB credit/duty drawback receipt reduces the value of purchases (cost neutralization), hence, it comes within first degree source as it increases the net profit proportionately. On the other hand, according to the Department, DEPB credit/duty drawback receipt do not come within first degree source as the said incentives flow from Incentive Schemes enacted by the Government of India or from Section 75 of the Customs Act, 1962. Hence, according to the Department, in the present cases, the first degree source is the incentive scheme/provisions of the Customs Act. In this connection, Department places heavy reliance on the judgment of this Court in Sterling Food (supra). Therefore, in the present cases, in which we are required to examine the eligible business of an industrial undertaking, we need to trace the source of the profits to manufacture. (see CIT v. Kirloskar Oil Engines Ltd. reported in [1986] 157 ITR 762)
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> 15. Continuing our analysis of Sections 80-IA/80-IB it may be mentioned that sub-section (13) of Section 80-IB provides for applicability of the provisions of sub-section (5) and sub-sections (7)

to (12) of Section 80-IA, so far as may be, applicable to the eligible business under Section 80-IB. Therefore, at the outset, we stated that one needs to read Sections 80I, 80-IA and 80-IB as having a common Scheme. On perusal of sub-section(5) of Section 80-IA, it is noticed that it provides for manner of computation of profits of an eligible business. Accordingly, such profits are to be computed as if such eligible business is the only source of income of the assessee. Therefore, the devices adopted to reduce or inflate the profits of eligible business has got to be rejected in view of the overriding provisions of sub- section (5) of Section 80-IA, which are also required to be read into Section 80-IB. [see Section 80-IB(13)]. We may reiterate that Sections 80I, 80-IA and 80-IB have a common scheme and if so read it is clear that the said sections provide for incentives in the form of deduction(s) which are linked to profits and not to investment. On analysis of Sections 80-IA and 80-IB it becomes clear that any industrial undertaking, which becomes eligible on satisfying sub-section(2), would be entitled to deduction under sub-section (1) only to the extent of profits derived from such industrial undertaking after specified date(s). Hence, apart from eligibility, sub-section(1) purports to restrict the quantum of deduction to a specified percentage of profits. This is the importance of the words "derived from industrial undertaking" as against "profits attributable to industrial undertaking".

16. DEPB is an incentive. It is given under Duty Exemption Remission Scheme. Essentially, it is an export incentive. No doubt, the object behind DEPB is to neutralize the incidence of customs duty payment on the import content of export product. This neutralization is provided for by credit to customs duty against export product. Under DEPB, an exporter may apply for credit as percentage of FOB value of exports made in freely convertible currency. Credit is available only against the export product and at rates specified by DGFT for import of raw materials, components etc.. DEPB credit under the Scheme has to be calculated by taking into account the deemed import content of the export product as per basic customs duty and special additional duty payable on such deemed imports. Therefore, **in our view, DEPB/Duty Drawback are incentives which flow from the Schemes framed by Central Government or from Section 75 of the Customs Act, 1962, hence, incentives profits are not profits derived from the eligible business under Section 80-IB. They belong to the category of ancillary profits of such Undertakings.**

17. The next question is - what is duty drawback? Section 75 of the Customs Act, 1962 and Section 37 of the Central Excise Act, 1944 empower Government of India to provide for repayment of customs and excise duty paid by an assessee. The refund is of the average amount of duty paid on materials of any particular class or description

> of goods used in the manufacture of export goods of specified class. The Rules do not envisage a refund of an amount arithmetically equal to customs duty or central excise duty actually paid by an individual importer-cum-manufacturer. Sub-section (2) of Section 75 of the Customs Act requires the amount of drawback to be determined on a consideration of all the circumstances prevalent in a particular trade and also based on the facts situation relevant in respect of each of various classes of goods imported. Basically, the source of duty drawback receipt lies in Section 75 of the Customs Act and Section 37 of the Central Excise Act.
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> 18. Analysing the concept of remission of duty drawback and DEPB, we are satisfied that the remission of duty is on account of the statutory/policy provisions in the Customs Act/Scheme(s) framed by the Government of India. In the circumstances, we hold that profits derived by way of such incentives do not fall within the expression "profits derived from industrial undertaking" in Section 80-IB.

10. In the illustration given by Their Lordships in this judgment, it was noted that in a situation in which overall profit of the assessee was Rs 200 and duty drawback receipt of the assessee was Rs 100, the revenue was justified in granting deduction under section 80 IB only in respect of Rs 100 and that "we are of the view that duty drawback, DEPB benefits, rebates etc. cannot be credited against the cost of manufacture of goods debited in the Profit & Loss account for purposes of Sections 80-IA/80-IB as **such remissions (credits) would constitute independent source of income beyond the first degree nexus between profits and the industrial undertaking.**" As we take note of these observations, and in order to ensure that things are put in the right perspective, we must also take note of another judicial precedent which has the approval of the Hon'ble Supreme Court. In the case of **Dharam Pal Premchand Ltd** *(supra),* Hon'ble Delhi High Court had an occasion to deal with the impact of Sterling Food decision by Hon'ble Supreme Court and to deal with the question as to whether deduction under section 80 IB was available with respect to refund of excise duty. Their Lordships decided the issue in favour of the assessee, and, in coming to this conclusion, held as follows:

In the case of CIT vs. Sterling Foods (supra), the Supreme Court was interpreting the provisions of s. 80HH of the Act. The Supreme Court was called upon to adjudicate income derived from the sale of import entitlements granted by the Central Government under the Export Promotion Scheme which the assessee could use itself or sell the same to others. The issue before the Supreme Court was whether the income from such import entitlements could be included in the total income for the purposes of claiming relief under s. 80HH of the Act. The Supreme Court came to the conclusion in the said case that the source of import entitlements was not the industrial undertaking of the assessee. According to the Supreme Court, the source of import entitlement in the circumstances was Export Promotion Scheme of the Central Government whereunder the export entitlements became available. **The Supreme Court further went on to hold that the expression 'derived from' entailed a direct nexus between profit and gains and the industrial undertaking. In that case, the Supreme Court found that the nexus was not direct but only incidental. According to us, the ratio of this judgment has no application to the case in the instant case. In the instant case both the CIT(A), as well as, the Tribunal found that the refund of excise duty had a direct nexus with the manufacturing activity carried out by the assessee**.

(Emphasis by underlining supplied by us)

Vide judgment dated 22.2.2010, the SLP against the above judgment was dismissed by Hon'ble Supreme Court another's division bench, headed by Hon'ble Justice S H Kapadia- who was incidentally also author of Liberty India decision by the same court and which constitutes bedrock of revenue's case.

11. A plain look at the above analysis of judicial precedents would show that what is really material is whether or not the duty drawback receipts are directly linked, which is sometimes also referred to as first degree nexus, with the profits of the industrial undertaking, or whether such receipts are only **"ancillary profits of industrial undertakings"** and are **"independent sources of income".** The question that Hon'ble Supreme Court had posed for adjudication by itself, in the case of Liberty India, was **"whether the DEPB credit/ Duty drawback receipt comes within the first degree sources** *( of such industrial undertaking)* **?** In answering this

question, Their Lordships did examine whether these receipts constitute **"ancillary profits of industrial undertakings"** and are **"independent sources of income**". In the case of **Sterling Foods** *(supra)* also, Hon'ble Supreme Court had laid down the principle that **"(t)here must be, for the application of the words 'derived from', a direct nexus between the profits and gains and the industrial undertaking"** and, on the facts of the said case, held that **"In the instant case, the nexus is not direct but only incidental"**. It is also important to bear in mind the fact that the import entitlement scheme, as it then stood, entitled the exporter to certain imports, not necessarily of the manufacturing inputs but even, for example, of entirely unrelated things such as office equipments etc. The profit or advantage on account of such import entitlements was essentially in the realm of such uncertainties that it could hardly get into costing of the production or pricing of the product. In **Liberty India's case**, Hon'ble Punjab & Haryana High Court relied upon the principle laid down in **Sterling Food decision** *(supra)*, and observed that distinction sought to be made by learned counsel for the assessee, in income derived from duty drawback and sale of import entitlements, could not be accepted as relevant distinction since "**core question before the Court was that such income was derived from specified business, which reasoning is fully applicable to the present situation**". What was thus implicitly held was that the duty drawback receipts were not from core activities of specified business – something which was upheld by Hon'ble Supreme Court as well. Hon'ble Supreme Court did hold that DEPB/ duty drawback receipts would "**constitute independent source of income beyond the first degree nexus between profits and the industrial undertaking**". Even in the illustration taken by Hon'ble Supreme Court, in the case of Liberty India *(supra),* overall profit is Rs 200, out of which Rs 100 is profit by way of receipt of duty drawback receipts and the other Rs 100 is profit by way of normal business profits. Such examples, however, hold good on the premises that duty drawback receipt is an additional, ancillary or supplemental profit. There

can, on the other extreme, be situations in which duty drawback itself could be more than the overall profits, and, in such cases, the approach implicit in the above illustration may not hold good. In these situations, the duty drawback receipts may not be seen on standalone basis or as an independent source of income because the overall profit is only a part of the duty drawback receipt, and the commercial motivation of running the industrial undertaking is earning only that part of duty drawback receipts. In today's competitive world, and somewhat perfect market conditions, such situations are not rare at all. Let us take the case of the assessee before us itself. As per the financial statements filed before us, entire operational before tax for the assessment year 2003—04 is year is Rs 51,56,169 whereas duty drawback receipts aggregate to Rs 82,27,439. Similarly, so far as assessment year 2004-05 is concerned, the entire operational profit before tax is Rs 55,76,307 whereas duty drawback receipts amount to Rs 1,08,64,469. In the next assessment year, i.e. 2005-06, the overall profits of the assessee are only Rs 1,05,27,484 whereas duty drawback receipts during the year come to Rs 1,31,08,550. It is only in the assessment year 2006-07 that overall profits before tax at Rs 1,80,44,357 are marginally more than duty drawback receipts of Rs 1,53,94,403. On these facts, as learned counsel rightly pleads, it cannot be an open and shut inference that the duty drawback receipts are independent sources of income on standalone basis and that these receipts have no first degree nexus with the business activity of the industrial undertaking. There is still a room for the consideration of the plea that but for the duty drawback, the assessee would not have carried out the business activity in the industrial undertaking, because, that would have meant carrying out business for incurring losses. If that be so, the duty drawback receipts cannot be said to be 'not direct but only incidental' income, an 'independent source of income' or 'ancillary profit of the industrial undertaking'. It is also important to bear in mind the fact that the very distinguished Hon'ble Justice, who authored judgment in **Liberty India's case** *(supra),* also dismissed special leave petition against **the**

judgment of Hon'ble Delhi high Court in **Lakahnpal Premchand Ltd's cas**e *(supra)*'s observations to the effect, "**In that case** *(i.e. Sterling Food)*, **the Supreme Court found that the nexus was not direct but only incidental. According to us, the ratio of this judgment has no application to the case in the instant case. In the instant case both the CIT(A), as well as, the Tribunal found that the refund of excise duty had a direct nexus with the manufacturing activity carried out by the assessee**". The views expressed in Sterling Food (supra) which is the basic foundation of revenue's case, therefore, remain confined to the those facts. When facts can shown to be materially different and when a receipt can be shown to have direct nexus with the manufacturing activity, such a receipt can indeed be included in computation of deduction under section 80 IB.

12. It is thus the nexus which was found to be missing in the case of **Liberty India's case**, but when nexus was found to be existing, as in **Premchand Lakhanpal's case**, the amounts were held to be eligible for deduction 80 IB. The true test, therefore, is not the nexus that the duty drawback has with the operations of business.

13. As we deal with this aspect of the matter, let us not lose sight of the fact that the expression **'first degree nexus between profits and industrial undertaking'** has been used, by Hon'ble Supreme Court itself in the decisions referred to above, interchangeably with **'independent source of income'**, **'not direct but only incidental'** and **'ancillary profits of industrial undertakings'**. Let us also not forget that in the case before the Hon'ble Supreme Court, in the case of **Liberty India** *(supra),* it was nobody's case that duty drawback was such a significant part of the receipts that but for duty drawback, even the business operations of the industrial undertaking would not make any commercial sense. In Their Lordship's illustration, set out in the judgment itself, the overall profits were twice the amount of duty drawback receipts as against the factual situation we are *in*

*seisin* of in which there will be virtually no commercial profits if duty drawback is to be ignored.

14. There is one more important aspect of this matter. The assessee is virtually a one hundred percent export oriented undertaking. As evident from the financial statements filed before us, the assessee had direct exports of Rs 16,95,65,561, indirect exports of Rs 3,85,17,858 and domestic sales of only Rs 16,144 – that too in respect of the factory disposables. Broadly the same has been the position in the other years before us, though, of course, there are deviations in the figures. What clearly emerges from these facts is that the industrial undertaking was used only for the purpose of manufacturing and exporting the export products. In a situation in which an important part of the revenues generated as a result of the exports, which is as high as almost 7.4% of total turnover, is duty drawback itself, it may not really be correct to say that duty drawback receipt is an incidental, unintended, ancillary or independent benefit, which can be seen as a standalone or independent source of income. Quite to the contrary, in such a situation, this receipt appears to be so much a part of the integral profits of the industrial undertaking that the absence of duty drawback receipt may take away the *raison d'être* of the industrial undertaking being put into business. This factual matrix is in sharp contrast with a situation in which, as was perhaps found, perceived or visualized by Hon'ble Supreme Court, the industrial undertaking is engaged in manufacturing of a product for domestic sales as also exports, and the export incentives are nothing more than an incidental, additional and ancillary sources of profits, in view of the position that *de-hors* such export incentives also the industrial undertakings make commercial sense.

15. To up a question to ourselves, what are the options open to us in this situation and on the facts of this case. On the one hand, the words employed in Hon'ble Supreme Court's judgment in **Liberty India's** case *(supra)* leave little doubt about the fact that, in the esteemed views of

Hon'ble Supreme Court, the duty drawback receipts donot have first degree nexus with the profits of the industrial undertaking, but then there is no warrant for the assumption that this approach must remain valid in all factual situations. Of course, it is tempting to proceed on the basis that this lack of first degree nexus is a legal principle, but then an issue like that of degree of nexus between nature of receipts vis-a-vis the industrial undertaking cannot be decided in vacuum; it has to depend on the facts, and business situations can never be so static or uniform that lack of nexus in one factual matrix must essentially imply lack of that nexus in all factual matrixes. On the other hand, on the peculiar facts of this case, duty drawback receipts, at least at the first sight, appear to be integral part of the business receipts, but for which even running of industrial undertaking does not make sense, and, therefore, it cannot be viewed as ancillary or incidental profits of industrial undertaking or a standalone and independent source of income. As we face this dilemma, we are reminded of the words of guidance by Hon'ble Supreme Court in **Mumbai Kamgar Sabha Vs Abdulbahi Faizullbhai (AIR 1976 SC 1455)** wherein legendary Justice V Krishna Iyer , in his inimitable and felicitous words observed thus, **"It is trite, going by Anglophonic principles that a ruling of a superior court is binding law. It is not of scriptural sanctity but of ratio wise luminosity within the edifice of facts where the judicial lamp plays the legal flame. Beyond those walls and de hors the milieu we cannot impart eternal vernal value to the decisions, exalting the precedents into a prison house of bigotry, regardless of the varying circumstances and myriad developments."** Of course, one has to balance these observations of Hon'ble Supreme Court about duties of the courts below with what another bench of this very Hon'ble Supreme Court has said, in the case of **Assistant Controller of Central Excise Vs. Dunlop India Ltd. (154 ITR 172**). In this case, Hon'ble Court has itself quoted from the decision of House of Lords as follows: **"We desire to add and as was said in Cassell & Co. Ltd. v. Broome [1972] AC 1027 (HL), we hope it will never be necessary for us**

**to say so again that "in the hierarchical system of courts" which exists in our country, "it is necessary for each lower tier", including the High Court, "to accept loyally the decision of the higher tiers". "It is inevitable in hierarchical system of courts that there are decisions of the Supreme appellate Tribunal which do not attract the unanimous approval of all members of the judiciary... But the judicial system only works if someone is allowed to have the last word, and that last word, once spoken, is loyally accepted. "... The better wisdom of the Court below must yield to the higher wisdom of the Court above. That is the strength of the hierarchical judicial system."** As we perform our pious judicial duties, we have to strive to find that point of equilibrium when a fine balance between these two observations of Hon'ble Supreme Court can be arrived at. This is by no means an easy task and, being highly as subjective as it is, it is perhaps incapable of unanimity in approach, but then that cannot be a ground enough to deal with the matters at a superficial level.

16. The question that we must, therefore, deal with, to ascertain whether or not duty drawback receipt in includible in computation of deduction under section 80 IB, is whether this particular receipt is an ancillary or additional profit and can be seen as an income on standalone basis or whether it is an integral part of the profits of the industrial undertaking. In our humble understanding, the answer to this question does depend more on the factual matrix of a case essentially because whether or not duty drawback receipts are additional incentive receipt or an integral part of the business receipt may vary on several factual factors. In a situation in which the duty drawback receipts are nothing but additional or incidental profits, and when even in the absence of duty drawback receipts, operations of industrial undertaking make business sense, as was the case before Their Lordships in Liberty India or as was visualized or perceived by Their Lordships, the situation will be different. However, the same may not be the situation in which duty drawback receipts are so significant and

substantial that they drive the business model and are constitute justifications for the commercial operations. While on this issue, we may also make reference to the Cost Accounting Standards formulated by the Cost Accounting Standards Board set up by the Institute of Cost Accountants of India, which, in turn, is established by a special Act of the Parliament. The official website of Cost Accounting Standards Board states that, "**The Institute of Cost Accountants of India, recognizing the need for structured approach to the measurement of cost in manufacture or service sector and to provide guidance to the user organizations, government bodies, regulators, research agencies and academic institutions to achieve uniformity and consistency in classification, measurement and assignment of cost to product and services, has constituted Cost Accounting Standards Board (CASB) with the objective of formulating the Cost Accounting Standards. The Expert Group constituted by Ministry of Corporate Affairs has specifically highlighted the need for developing Cost Accounting Standards on the basis of Generally Accepted Cost Accounting Principles".** The cost accounting standards thus provide important insight into the generally accepted standards so far as cost accounting is concerned. This is in sharp contrast with AS 2 issued by the Institute of Chartered Accountants of India which deals with, as the AS 2 itself states, "the determination of the value at which inventories are carried in the financial statements until the related revenues are recognised". In other words while AS 2 deals with how the inventories are to be reflected in the yearend financial statements, which has nothing to do with determination of costs, CAS 1 deals with, as it specifically so states, "classification of costs for ascertainment of cost of a product or service and preparation of cost statements on a consistent and uniform basis with a view to effect the comparability of the same of an enterprise with that of previous periods and of other enterprise". While CAS 1 thus provides good guidance on what constitutes 'cost' from the management point of view, AS 2 provides guidance on how should the inventories be valued and reflected in

the yearend financial statements. Let us in this backdrop take a look at the CAB 1 (Cost Accounting Standard 1) issued by the Institute of Cost Accountants of India, which deals with the question as to how the costs should be recognised, which states as follows:

> **6.1.2 Material Cost is the cost of material of any nature used for the purpose of production of a product or a service.**
>
> **6.1.3 Material cost includes cost of procurement, freight inwards, taxes and duties, insurance etc directly attributable to the acquisition. Trade discounts, rebates, duty drawbacks, refunds on account of modvat, cenvat, salex tax and other similar items are deducted in determining the costs of material.**
>
> *http://casbicwai.org/CASB/casb-resources-download.asp*
> (Emphasis by underlining supplied by us)

17. It is thus clear that in a particular fact situation, even material cost may be required to be adjusted for duty drawback. Of course, the crucial question is whether the duty drawback is an incidental profit or a profit of the first degree which, in turn, depends on the business models. Take for example a situation in which an assessee is manufacturing precision equipments and selling the same in domestic as well as international markets. The industrial undertaking so manufacturing precision equipments is a commercial venture for making profits, and exports or no exports, the industrial undertaking is in business anyway. In such a situation, in case the assessee is able to make some exports of the same product on the similar price, the duty drawback income is an incidental or standalone income. However, in another situation, in which, for example, the assessee is a one hundred percent exporter, and he is operating on the basis of costs duly adjusted by duty drawback, as evident from the fact that but for duty drawback receipts, he will have virtually no profits, the duty drawback receipts could as well have the first degree nexus since these cannot be viewed as incidental or ancillary profits or standalone income.

18. Everything thus hinges on the findings about the degree of nexus between duty drawback receipts and the industrial undertaking, and it is only when there is a clear finding on this aspect that the correctness of assessee's claim can be tested on the principles of law. There is no finding on this aspect by any of the authorities below. The Assessing Officer, as also the CIT(A), have proceeded on the implicit basis that in the light of observations made in Hon'ble Supreme Court's judgment in Liberty India's case *(supra)*, there can never situations in which duty drawback receipts have first degree nexus with operations of industrial undertaking. Legal principles, which have been relied upon by the authorities below, do bind us but these legal principles are related to factual matrix and when factual matrix has significant and material variations vis-à-vis the factual matrix on which the legal principles were laid down, the entire scenario changes. What is thus equally, if not more, important thus is the factual matrix and as to what extent the legal principles in one fact situation will find application in another seemingly similar, but materially different, fact situation. What should have been really examined by the authorities below is whether or not, on the facts of this case, the duty drawback receipts can be said to have first degree nexus with the industrial undertaking or whether these profits can be said to be ancillary, incidental or standalone income. In our considered view, this aspect of the matter ought to have been examined in detail and by way of a speaking order. That exercise has not been carried out at all. We, therefore, remit the matter to the file of the CIT(A) for adjudication *de novo* by way of a speaking order, in the light of our above observations, in accordance with the law, and, after giving yet another opportunity of hearing to the assessee. While doing so, learned CIT(A) will also deal with alternate contention of the assessee to the effect that, in any event, to the extent the duty drawback receipts represent refund of duties by the assessee, which assessee can demonstrate and establish, the same shall be includible in profits of the assessee eligible for deduction under section

80 IB. In the event, however, of the basic plea being accepted, this aspect of the matter will be rendered academic.

19. To the extent above, grievance of the assessee is upheld to the extent that the matter regarding the duty drawback receipts being includible in computation of deduction under section 80 IB deserves to be re-examined by the CIT(A) as directed above. What we have decided for the assessment year 2006-07, learned representatives fairly agree, will also apply *mutatis mutandis* for the three other assessment years, i.e. assessment year2002-03, 2003-04 and 2004-05. No other issues were pressed before us.

20. However, as we remit the matter back to the file of the CIT(A), we make it clear that we have only remitted the matter, for a finding on a factual aspect, to the file of the CIT(A). This direction should not be construed as any adjudication on the legal issue which remains open and which is to be adjudicated, in the light of binding judicial precedents as available now and as may be available at the relevant point of time, after findings on foundational factual aspects referred to earlier in this order. We are alive to the fact that even in the event of the DEPB receipts not being in the nature of incidental profits, separate source of income or ancillary gains, there are categorical observations in Liberty India decision which may end up deciding the issue against the assessee but that is not material at present. This adjudication by us is certainly not the end of the road but when the matter travels to higher forums, it is certainly appropriate that all the relevant facts are before Their Lordships. In any event, whatever we say is, and shall always remain, subject to the law laid down by the Hon'ble Courts above and we have to apply the same in letter, and also in, spirit. A judgment of Hon'ble Supreme Court does bind all of us under article 141 of the Constitution of India but it does not prevent us from discharging our duty of ensuring that all the relevant and material facts are placed on record. In any case, as Hon'ble Justice V R Krishna Iyer has said, in his inimitable

words, that **"….*de hors* the milieu we cannot impart eternal vernal value to the decisions, exalting the precedents into a prison house of bigotry, regardless of the varying circumstances and myriad developments".** In our humble understanding, the expression 'milieu' in this context not only refers to the actual facts of the case but also as perceived, envisioned or visualized by Their Lordships, based on which the judgment is rendered. Our endeavour is to keep all the relevant material aspects on the record so that Hon'ble Courts above can view the things in the proper perspective and be pleased to take a just and proper legal view on the same, as and when the occasion so arises. Ascertaining and presenting the facts in proper perspective does contribute to efficacious and healthy development in this dynamic field. As a final fact finding authority, it is our most important duty to do so. With utmost humility and highest reverence to the judgments of Hon'ble Courts above, and within our limited abilities, we have attempted to do so. Our observations may be viewed in this light.

21. In the result, all the four appeals are allowed for statistical purposes in the terms indicated above. Pronounced today on 27th day of August, 2013.

***Sd/xx*** ***Sd/xx***
**(Sunil K Yadav )** **(Pramod Kumar)**
Judicial Member Accountant Member
*Lucknow; 27th day of August 2013.*
*Copy forwarded to :*
1. *The appellant*
2. *The respondent*
3. *Commissioner , Lucknow*
4. *Departmental Representative, bench, Lucknow*
5. *Guard File*

***True Copy***

*By Order etc.*

*Assistant Registrar*
*Income Tax Appellate Tribunal*
*Lucknow benches, Lucknow*