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Apex Court goes the "*Stricter Route*", negates Taxpayer's claim of "*Liberal Interpretation*"

Snapshot

In absence of fulfilling the eligibility criteria of claiming deduction under section 80-O, the Apex Court rejected the claim of giving such deduction though the objective of getting foreign exchange in India has been fulfilled by the Taxpayer.

The Hon'ble SC has reiterated the principle that instead of literal construction, a purposive construction is not to be applied to test fulfilment of eligibility criteria of claiming any tax benefit. Wide and liberal construction shall be applicable when there is no ambiguity on fulfillment of eligibility criteria of claiming any tax deduction.

Facts

R & Co. [1] (the Taxpayer) is a partnership firm engaged in providing services to its foreign customers of frozen seafood and/or marine products. As per the terms of the agreement, the Taxpayer was providing bundle of services to the foreign enterprises which enabled the foreign enterprise to organize, develop, regulate, and improve their business. The Taxpayer was primarily communicating its expert opinion about the marine product, advising and /or sharing information about reliable source of quality, its prices and latest trends in India with the NR.

In lieu of above services, it had received service charges income from the foreign customers in foreign exchange. The Taxpayer had claimed deduction u/s 80-O of the Income Tax Act, 1961 ("the ITA") from A.Y. 1993-94 to A.Y. 1997-98.

The Taxpayer was of the view that the myriad services rendered by it to non-residents are eligible services rendered from India and therefore it is entitled to claim deduction us 80-O since it has received the consideration in convertible foreign exchange in India.

The Assessing Officer (AO) after considering the terms of the agreements and actual conduct of the Taxpayer

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[1] ***Ramnath & Co. Vs. CIT*** *Civil Appeal Nos. 2506-2509 OF 2020 (Arising out of SLP (Civil) Nos. 23535 – 23538 of 2016) and Civil Appeal No. 2510 of 2020 @ SLP(C) No. 23699 of 2016*

denied the claim of the Taxpayer u/s 80-O on the following grounds.

i.) The Taxpayer is merely acting as an agent of the foreign customers in the matter of procurement of marine products **in India.**

ii.) The services rendered by Taxpayer such as inspections, packaging, supervision of processing and negotiating price etc. are incidental to primary function of acting as an agent which are performed **in India.**

iii.) The board's circular No.700 dated 23.03.1995 (herein after referred to as "Board's circular" in short) relied upon by the Taxpayer is also not applicable to the facts of the case.

The first appellate authority has set aside the order of the AO and allowed the relief to the Taxpayer. It has held that the Taxpayer is providing eligible services to foreign enterprises and all the conditions of section 80-O are complied with. It has placed reliance on Board's circular and the decision of Delhi HC in the case of E.P.W Da Costa and Ors v Union of India in support of the Taxpayer's claim.

The ITAT further concurred with the claim of the Taxpayer u/s 80-O. The ITAT has categorially held that the services rendered by the Taxpayer are specialized and technical services and the foreign enterprises have taken decision either to purchase or not the marine product based on this technical information. Therefore, considering the legislative intent of 80-O vis-a-vis Board's circular, these services were rendered by the Taxpayer **from India**.

The Kerala High Court (HC) however dissented with the view expressed by the ITAT and held that the Taxpayer is merely acting as marine product procurement agent in India. The HC distinguished the applicability of Board's circular and decisions relied upon by the Taxpayer and held as under:

i.) Mere transmission of information to a foreign enterprise does not mean service rendered **from India**.

ii.) In terms of section 80-O, it is essential to establish that such service, though rendered **in India,** but was essentially performed **outside India**.

Every spread of services rendered by Taxpayer to the foreign enterprise would not fall within the ambit of section 80-O. The purpose of section 80-O is to provide an incentive to the indigenous know-how of whatever nature to the foreign nations.

Questions before the SC

Aggrieved by the Order of the HC, the Taxpayer has preferred an appeal before the Supreme Court ("the SC"). The Hon'ble SC considered the following substantial question of law.

i.) Whether the services provided by the Taxpayer falls within the sweep of section 80-O and what is the true import of the expression **"use outside India"**.

ii.) While interpreting taxing provision, is it essential to place excessive reliance on the dictionary meaning ignoring the basic object and purpose of the said provision.

Taxpayer's contentions

The incentive provision like section 80-O must be construed purposively, broadly, and liberally. The objective of section 80-O is to earn foreign

exchange and therefore, the incentive is to be allowed if the objective is met. The Taxpayer placed reliance on decision of Hon'ble SC in case of Baby Marine Exports (290 ITR 323).

In terms of the Board's circular, it is quite clear that not only service rendered **outside India** but also services rendered **from India** to party **outside India** would also be included and it does not matter if the services ultimately utilized by foreign customer **in India**.

If the recipient of services is located **outside India**; then all services rendered by it would be covered within the ambit of section 80-O.

Revenue's contentions

The taxing statutes are subject to rule of strict interpretation and in case of any ambiguity, the benefit should go in favuor of the Revenue. The Revenue placed strong reliance on the decision of the constitution bench in case of **Dilip Kumar & Co. and Ors** (9 SSC 1).

In terms of the agreement and actual conduct of the Taxpayer, the bundle of activities performed by the Taxpayer are essentially in the nature of "buying or procuring agent" and all such activities are performed **in India**.

Lastly, in absence of any material placed on records by the Taxpayer that part of service charges received by it has nexus with any technical services to party **outside India**, the deduction cannot be allowed u/s 80-O.

Taxpayer's contention *via* Rejoinder

The decision of Dilip Kumar & Co. and Ors (SC) deals with the interpretation of exemption provision and therefore said principle cannot be applied mutatis-mutandis for interpreting incentive provisions like section 80-O.

Finding of the Hon'ble SC

Rules of interpreting Incentive provisions

In the context of taxing statutes, the meaning of any word, or phrase used therein is required to be understood in its natural, ordinary, and grammatical meaning. To gather natural and ordinary meaning of any expression, recourse to dictionary meaning is inevitable whilst applying the literal rule of interpretation. Once the meaning or expression fits within the scheme and object of the statute, it needs to be applied and there is no room for any intendments.

Provision under taxing statutes providing for any deduction, rebate, incentives etc. to the Taxpayer are required to be construed strictly. The liberal and strict construction of exemption provision are to be invoked at two different stages of interpreting it. At the stage of deciding applicability, one cannot alter, amend, and expand the ambit of the provision. Once the eligibility is decided, the provision will apply with full force and may be given liberal interpretation.

Consequently, the Hon'ble SC categorically held that the judicial precedents laying down the principle that incentive provision must receive liberal interpretation is no longer valid law. The decision of Baby Marine Products (supra) and others laying down this principle therefore **stand overruled**.

Ambit of section 80-O - *Services performed from India*

The nomenclature used by the Taxpayer for labeling different service in the agreement would not be decisive. In terms of section 80-O, the substance of services performed by the Taxpayer should strictly confine within the scope of eligibility.

Merely having contract with person **outside India** does not ipso facto mean that every service provided covered by the agreement would come within the ambit of scheme of 80-O. Bundle of activities/services performed as per the agreement are only confined to activity of procuring agent which are further performed **in India.**

No part of the service charges is essentially attributable or linked to the allied services of imparting information, survey etc. to the foreign enterprises and therefore, the deduction is denied at very threshold.

KCM Note

The SC has once again discussed the cardinal principles of interpreting taxing statute. The claim of the Taxpayer has been rejected at the threshold of eligibility test. This decision therefore lays down very important principles for interpreting taxing provision particularly those provisions which are providing incentives, benefits, etc. to the Taxpayer.

The decision of the SC reinforces the principle that while interpreting any provision of taxing statutes, there is no supremacy of Rule of liberal construction over strict construction. Both these principles operate at different stage of interception and both principles can also co-exist whilst construing any provision.

The taxing provision are therefore subject to strict rule of interpretation and there is no exception to it. The burden is on the Taxpayer to establish that it is covered within the broad ambit of scheme and the Taxpayer cannot claim any benefit or incentives provided by the legislature as matter of right.

The provisions enacted with beneficent objects are meant for encouraging or promoting activities such as encouraging export, setting up of new industry, increase production or encouraging new investment in P&M and so on. It is relatively settled position of law that such provisions are required to be liberally interpreted considering the broad objective of the scheme.

The court usually takes pragmatic view of the exemption provision to remove any anomaly or absurdity. However, the SC in this sweeping decision has categorically laid down that taxing provision are subject to strict rules of construction to test compliance with eligibility criteria, no matter how close a taxpayer is to fulfilling the objective criteria of such tax deduction.

Whilst adjudicating the issue of scope of section 80-O in the factual matrix of the case, the SC has held that in case of ambiguity in taxing provision, benefit being conferred upon the Taxpayer claiming the benefit is not correct position of law. The Hon'ble SC has discussed the decision of Dilip Kumar & Co. and Ors of larger bench of the constitution which has binding force over the earlier decisions of the SC relied upon by the Taxpayer delivered by smaller bench.

The Hon'ble SC in the matter of CCE v Hari Chand Shri Gopal (2011) 1 SSC 236 has also laid down that

if there is any condition stipulated for claiming any benefit, then the concept of liberal construction would not arise. In view of the above, the legal position that emerges is that in case of any ambiguity in taxing provision granting any benefit or incentives to the Taxpayer shall always be subject to strict construction and once the threshold of eligibility and applicability is crossed by the Taxpayer, Court may take recourse to liberal approach thereafter. The rules of liberal construction and strict construction usually apply at different stages of interpretation and there is no supremacy of one over the other.

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