

Taxability And Accounting Treatment Under DEPB Scheme

Duty Entitlement Pass Book (DEPB) scheme was declared by the Customs Notification No. 45/2002 dated 22.04.2002 in exercise of powers conferred by section 25(1) of the Customs Act, 1962. The objective of the scheme is to neutralise incidence of customs duty on the import content of export product. According to the said Notification, goods imported into India are exempt from the Customs/Import duty subject to, *inter alia*, the following conditions: -

(a) Importer has been issued a Duty Entitlement Pass



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Book by the Licensing Authority.
(b) There are sufficient credit entries in the said Duty Entitlement Pass Book by the Licensing Authority at the rates notified by the Government of India for the products exported.

Furthermore, as per clause (vi) of the aforesaid Notification, the benefit of exemption from duty is transferable to another person/entity against specific amount of credit.

Therefore, the licence issued by the Director General of Foreign Trade (DGFT) containing the value of Duty credit can be sold in the market and cash can be realised therefrom. The credit is granted by the DGFT on the basis of notified entitlement rates, which are notified by DGFT as a percentage of FOB value on the basis of Standard Input Output Norms and deemed import content. However, the credit of duty in the pass-book also entitles the exporter to directly import goods like raw materials, packaging material, components, etc, which are otherwise eligible for imports without paying duty subject to credit entitlement. But it is important to note that capital goods cannot be imported under DEPB scheme.

Entitlement to 80HHC deduction

A question raging in the minds of exporters all over the country is whether they can claim deduction as per proviso to sub-section (3) of section 80HHC on the credit entitlement of DEPB licence.

It is pertinent to note here that as per the said proviso, 90 per cent of the sums referred to in clauses (iiia), (iiib) and (iiic) of section 28 are eligible for deduction u/s 80HHC (kindly note that benefits u/s 80HHC are to be



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completely phased out w.e.f. A.Y.: 2005-06). The aforesaid three clauses of section 28 are set out hereunder: -

- (iiia) Profits on sale of a licence granted under the Imports (Control) Order, 1955, made under the Imports and Exports (Control) Act, 1947 (18 of 1947);
- (iiib) Cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the government of India;
- (iiic) any duty of customs or excise re-paid or repayable as drawback to any person against exports under the Customs and Central Excise Duties Drawback Rules, 1971;

The DEPB licence scheme has to be analysed on the touchstone of the aforementioned criteria for the purpose of eligibility of deduction. As far as clauses (iiia) and (iiic) are concerned, there is no doubt that the amount received on the sale of credit entitlement/sale value does not fall under these clauses as they refer to separate enactments and/or rules. The only clause under which the benefit that can possibly be claimed is clause (iiib) according to which an amount eligible for deduction should be of the nature of “cash assistance by whatever name called, received or receivable by any person against exports under any scheme of Government of India.”

CBDT declines clarification

On the representation received by the exporters that the department is taxing DEPB benefits, CBDT issued instructions to keep the process of taxing DEPB benefits in abeyance since August, 2003. CBDT also appointed a committee to look into the matter and the assessments were kept in abeyance initially up to November 2003 but the date was extended till February 17, 2004.

In the circular dated February 17, 2004 [published in 266 ITR 61(st.)], CBDT has stated that it is not possible for it to intervene in the matter. Thus, the issue has

been left open for interpretation by the judiciary.

Taxability of DEPB

The words “cash assistance” being juxtaposed with the expression “by whatever name called” are capable of very wide construction.

Further, use of words “against exports” and “under any scheme of Govt. of India” connotes that the receipts in the nature of “cash assistance” need not be directly from the Governmental agency. The expression “cash assistance” has not been defined in the Act. Therefore, we have to look to its ordinary dictionary meaning. As per the Oxford Large Print Dictionary, word “assist” means “to help”. In other words, the receipts in question should be of the nature of “help” which means as per the aforesaid dictionary, “to make it easier for (a person) to do something”.

It is a well known fact that various incentives are provided to the exporters to make it easier for them to compete in the international market where the players from the developed economies are better placed in terms of infrastructural facilities and lower cost.

In author’s view, clause (iiib) was inserted by the legislature to ensure all types of reliefs in any form given to exporters and not specifically covered under clause (iiia) and (iiic) should be available to exporters for exemption.

Therefore, the amount receivable on the sale of credit entitlement under the DEPB licence scheme or notional duty benefit credited in the accounts

on the import of goods needed as raw materials etc. should fall under clause (iiib) of section 28 and qualify for deduction under section 80HHC.

Judicial Precedent

Direct judicial precedents on the issue of taxability of benefits under DEPB scheme are not available as the scheme is of recent origin. However, question arose, in respect of a similar scheme, before the Ahmedabad



Bench of the Tribunal in the case of *ACIT vs. Pratibha Syntex Ltd.* 63 TJJ 409/106 Taxman 32(Mag.)- whether the notional customs duty benefit derived by the assessee on the import of goods needed as raw materials for the manufacture of goods exported by the assessee would fall under the term “cash assistance” envisaged under section 28 (iiib) so as to be eligible for deduction as per the provisions of section 80HHC. The Tribunal observed, deciding the issue in favour of the assessee, as follows (at para 13 of its order): -

“Thus, clause (iiib) does not mean receipt of cash assistance direct from the Government. The words “whatever name” called expand the meaning of the term “cash assistance”. The addition of these words are not meaningless or an idle formality since such words are not found added elsewhere in the Act. Thus it has to be held that clause (iiib) was inserted to ensure that all other reliefs given in any form to the exporters not specifically covered under clause (iiia) and (iiic) should not be left out. In this particular case, the duty payable to the Government of India, but not paid under the scheme of the Government, is nothing but cash assistance in the hands of the assessee and the method of accounting adopted by the assessee for identifying and accounting the same in the books of account to claim the necessary deduction under section 80HHC cannot be faulted.

Accordingly, we are of the considered opinion that the duty benefit available to the exporter under any of the schemes of the Government of India like the one referred to in para 13(3) falls under the proviso of section 28(iiib) and section 80HHC of the IT Act, 1961 making the exporter eligible to claim the necessary deduction”.

Accounting Treatment

AS-12 issued by the Council of the Institute of Chartered Accountants of India on “Accounting for Government Grants” is applicable in respect of benefits derived by the exporters under DEPB scheme. This standard has become mandatory in respect of accounts for periods commencing on or after 01.04.1994. As per this standard the benefits under the scheme should not be recognised in the books until there is reasonable

assurance that the enterprise will comply with the conditions attached to them and the credits will be received (see para 13 of the standard). Other salient features of the standard as far as relatable to the DEPB scheme are: -

- (a) An appropriate amount in respect of duty entitlement earned during the year in respect of exports made, estimated on a prudent basis, is credited as income for the year even though the actual amount of such benefit may be settled/sold after the end of the relevant accounting period.
- (b) A contingency arising after duty entitlement has been recognised in the accounts is to be treated in accordance with Accounting Standards (AS-4), Contingencies and Events Occurring After the Balance Sheet Date.
- (c) Duty entitlement benefit should be taken to income and matched with the associated costs.

There are two methods of representation in the accounts. Either it may be shown separately under “other income” or alternatively, deducted in reporting the related expense. Suppose duty entitlement for an enterprise in a particular year is Rs. 10 lakhs and the same is appropriated fully against the raw materials import of say, Rs. one crore on which import/customs duty exigibility is Rs. 10 lakhs.

Option 1: Rs. 10 lakhs will be taken to income in Profit and Loss account and raw material cost will be shown at Rs. 1 crore + Rs. 10 lakhs.

Option 2: Nothing is taken to income account. Raw material cost is shown as

Cost of raw Material:	Rs. 1.10 crore
Less: DEPB benefit:	<u>Rs. 0.10 crore</u>
	<u>Rs. 1.00 crore</u>

It may be seen that both the options have the same impact in the profit and loss account. But Option 1 is preferable. One, it facilitates comparison with other expenses. Two, it avoids confusion at the assessment stage and thereby unnecessary litigation as the figures necessary for computing deduction under section 80HHC are readily available on the credit side of the Profit and Loss account.