* **IN THE HIGH COURT OF DELHI AT NEW D**

ITA No. 251 of 2008

Reserved on: 25th November, 2009
% Pronounced on : 23rd December, 2009

Commissioner of Income Tax . . . Appellant

through : Mr. N.P. Sahini, Advocate.

VERSUS

Jackson Engineers Ltd. . . .Respondent

through: Mr. Kanan Kapoor, Advocate.

CORAM :-
THE HON'BLE MR. JUSTICE A.K. SIKRI
THE HON'BLE MR. JUSTICE SIDDHARTH MRIDUL

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI, J.

1. This appeal was heard on the following two questions of law:

> "i) Whether on the facts of the present case, the Tribunal was justified in law in allowing deduction under Section 80IA of the Act in disregard of the fact that the activity carried on by the assessee did not qualify as "manufacturing activity" for the purpose of under Section 80IA?"
>
> ii) Whether on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that the incidental business income derived by the assessee in the shape of interest income and advances from customers amounting to Rs.21,39,626/- and Rs.44,45,508/- respectively was eligible for deduction under Section 80IA of the Act?"

Sans unnecessary details, symptomatic facts for decid questions of law are recapitulated are as under:

The assessee carries on business of assembling diesel generating sets at its various units, including the unit under reference located at Daman. For the assessment year under consideration, as in the earlier assessment year, it claimed deduction under Section 80IA of the Income Tax Act (hereinafter referred to as 'the Act') in the sum of Rs.1,80,57,561/- in respect of profit derived from the Daman Unit. The Assessing Officer disallowed the deduction on the ground that the activity of assembling gensets from various components did not amount to manufacture or production of any articles or thing. For taking this view, the AO placed reliance on the detailed discussion as contained in the assessment order for the assessment year 1995-96 passed in the assessee's own case.

3. The assessee went in appeal before the CIT (A) and it contended that diesel generating set is an item of plant and machinery required by business for meeting their power requirements. The assessee company assembles DG sets of different kinds upto 1500 KVA range. Several components go into the making of a diesel generating set some of the major components are engine, alternator, engine instrument panel, base place, fuel tank, control

silencer and other components. The assessee company p the engine and the alternator as per the requirement and choice of the customer. Engines are procured from the leading manufactures of the same, *viz*., M/s Kirloskar Oil Engines Ltd., M/s. Ashok Leyland, M/s Jyoti Ltd. and M/s NGEF. The alternators are procured from M/s Kirloskar Oil Engines and other manufactures. Batteries, control panel, fuel tanks, base frames, leads, silencer, etc. are similarly procured from the outside vendors; in the case of base frames, control panel, fuel tanks, silencers and other components. The assessee gets them manufactured as per its designs and specification, specifying the type of materia to be used. The assessee company has now sets up its own independent manufacturing unit at Noida to manufacture control panels required by its Daman Unit.

It is contended that the assembly of components involves coupling and aligning with the engine and alternator. This is a matter of great skill and technical expertise. It is carried out manually. The assessee has on its rolls qualified engineers, technician and electricians to perform this job. If the engine and alternator are not coupled properly, there could be server vibration when the generating set is run, and this can damage the engine, the alternator and other components that are fitter in the DG set. Chain pulley blocks are used to lift the engine and

components. After the coupling is done, the engine and alternator are mounted on a base framed. The base frame is a solid iron channel, designed and cut to suit the type of DG set to be assembled. It has to be strong not only to support the weight of the DG set mounted on it, but also to withstand the pressure when the DG set is run. Grooves are made in the base frame. The engine and the alternator are affixed to the base frame by means of nut and bolts fitted in the grooves. Other components are fitted to complete the DG set. The function of the control panel is to indicate the voltage and the current that is generated. It is fitted with switches and instrument to regulate and control the power supply. Diesel is stored in the fuel tank. The function of the battery is to provide the initial current required to start the engine. The function of the silencer is to diminish the sound of the DG set when it runs. The function of the radiator is to maintain the temperature of the DG set. The above components constitute the inputs in the manufacture of a diesel generating set. The DG set is the final product which has a distinctive name, character and function different from each of the computation.

On the aforesaid, the CIT(A) held that the activity of the assessee amounts to manufacture. For this purpose, the CIT(A) also relied upon earlier orders passed by the Income Tax

respect of the assessee itself. The Tribunal has affirm finding.

4. Insofar as operation/activity undertaken by the assessee is concerned, which is described in detail above, it is a finding of fact which has arrived at and it cannot be disputed. Such an activity would amount to manufacture. When we apply the principles laid down in various judgments explaining what amounts to "manufacture activity" on the aforesaid fact, irresistibly conclusion would be that it would be treated as "manufacturing activity". In the case of assessee itself, this issue stands decided in its favour by the judgment of this Court deciding on 11.08.2009 in ITA No. 149 of 2001 and other connected cases. Relevant portion of that judgment reads as under:

> "6. Submissions before us remain the same. We are of the opinion that the case is directly covered by the judgment of the Apex Court in ***Aspinwall & Co. Ltd.* v. *Commissioner of Income Tax, Ernakulam***, (2001) 7 SCC 525. In that case the assessee was engaged, *inter alia*, in curing of coffee for which it had installed coffee-curing plants. It had claimed investment allowance under Section 32-A of the Income-Tax Act which depended upon the issue as to whether the process of curing the coffee would amount to manufacturing or production activity. Answering the question in the affirmative, in favour of the assessee, the Court explained the expression "manufacture" as under:-
>
> > "**13.** The word "manufacture" has not been defined in the Act. In the absence of a definition of the word

forms, qualities or combinations whether by hand lab
or machines. If the change made in the article result
a new and different article then it would amount to a manufacturing activity.

14. This Court while determining as to what would amount to a manufacturing activity, held in *CST* v. *Pio Food Packets*, 1980 Supp. SCC 174 that the test for determination whether manufacture can be said to have taken place is whether the commodity which is subjected to the process of manufacture can no longer be regarded as the original commodity, but is recognized in the trade as a new and distinct commodity. It was observed: (SCC p. 176, para 5).

> "Commonly manufacture is the end result of one or more processes through which the original commodity is made to pass. The nature and extent of processing may vary from one case to another, and indeed there may be several stages of processing and perhaps a different kind of processing at each stage. With each process suffered, the original commodity experiences a change. But it is only when the change, or a series of changes, take the commodity to the point where commercially it can no longer be regarded as the original commodity but instead is recognized as a new and distinct article that a manufacture can be said to take place."

15. Adverting to facts of the present case, the assessee after plucking or receiving the raw coffee berries makes it undergo nine processes to give it the shape of coffee beans. The net product is absolutely different and separate from the input. The change made in the article results in a new and different article which is recognized in the trade as a new and distinct commodity. The coffee beans have an independent identity distinct from raw material from which it was manufactured. A distinct change comes about in the finished product."

7. When we apply the aforesaid principle on the facts of the present case, the irrefutable conclusion would be that the respondent company is indulging in manufacturing activity. We, thus, answer the question formulated in favour of the assessee and uphold the view of the Tribunal on this aspect.

5. This question is thus answered in favour of the assessee and

against the Revenue.

The assessee had shown income of Rs.95,34,188/- f Daman Unit as other income. Major receipt was on account of interest of Rs.85,76,063/-,which is earned mainly from fixed deposits made with banks. The assessee had claimed deduction of this income under Section 80IA. This income is in three forms:

a) Interest earned from FDRs kept with the Bank;

b) Interest income from customers; and

c) Advances from the customers received which were forfeited.

The AO held that the assessee would not be entitled to this benefit, as this income was not "derived from" the industrial undertaking. The Tribunal has remitted the case back to the AO to consider the matter afresh in respect of interest earned from FDRs kept with the Bank to find out as to whether the Bank had insisted for FDR as collateral security or not and then decide the issue. We are not concerned with this aspect in this appeal. The question as formulated clearly shows that we have to deal with other two aspects of income to find out as to whether those would be eligible for deduction under Section 80IA of the Act.

7. Before we do so, we make it clear that under Section 80IA, the assessee has to prove that the income was "derived from"

from the income "derived from" and income "attributable industrial undertaking.

8. Now there is an authoritative pronouncement of judgment by the Supreme Court in the case of ***Liberty India*** vs. ***Commissioner of Income Tax*** [(2009) 317 ITR 218] on this aspect, in the following words:

> "8. On the nature of DEPB it was submitted that the amount of DEPB was granted under Exim-Policy issued in terms of powers conferred under Section 5 of the Foreign Trade (Development and Regulation) Act, 1992. According to the appellant(s), the DEPB Scheme is a Duty Remission Scheme which allows drawback of import charges paid on inputs used in the export product. The object being to neutralize the incidence of customs duty on the import content of the export product by way of grant of duty credit. The DEPB benefit is freely transferable. Thus, according to the appellant(s), duty drawback/DEPB benefit received had to be credited against the cost of manufacture of goods/purchases debited to the Profit & Loss account. That, such credit was not an independent source of profit. In this connection reliance has been placed on Accounting Standard-2 issued by ICAI on "valuation of inventories" which indicates that while determining cost of purchase, cost of conversion and other costs incurred in bringing the inventories to their present location and condition should be considered and that trade discounts, rebates, duty drawback and such other similar items have to be deducted in determining the cost of purchase. Placing reliance on AS-2, it was submitted that where excise duty paid was subsequently recoverable by way of drawback, the same would not form part of the manufacturing cost. It was submitted on behalf of the appellant(s) that payment of excise duty/customs duty on inputs consumed in manufacture of goods by an industrial undertaking eligible for deduction under Section 80IB, was inextricably linked to the manufacturing operations of the eligible undertaking without which manufacturing operations cannot be undertaken, hence the duty, which

eligible undertaking and consequently t reimbursement of the said amount cannot be treated income of the assessee(s) dehors the expense originally incurred by way of payment of duty. Consequently, according to the appellant(s), receipt of duty drawback/DEPB stood linked directly to the manufacture/production of goods and therefore had to be regarded as profits derived from eligible undertaking qualifying for deduction under Section 80IB of the 1961 Act. On behalf of the appellant(s) it was further submitted that this Court's decision in **Sterling Food** (supra) dealt with availability of deduction under Section 80HH with respect to profit on sale of import entitlements. The said decision, according to the appellant, had no applicability to the issue under consideration for the reason that import entitlement/REP licence was granted by the Government on the basis of exports made; the same were granted gratuitously without antecedent cost having being incurred by the industrial undertaking, unlike duty drawback and DEPB, which had direct link to the costs incurred by such industrial undertaking by way of payment of customs/excise duty in respect of duty paid inputs used in the manufacture of goods meant for export and in such circumstances, profit from sale of import entitlements/REP licence was in the nature of windfall and it was in those circumstances, that the apex Court held that source of profit on sale of import entitlements was not the industrial undertaking but the source was the Export Promotion Scheme. According to the appellant(s), in the case of sale of import entitlements/REP licence, the source was the Scheme framed by Government of India whereas in the case of DEPB/duty drawback, the source was the fact of payment of duty in respect of inputs consumed/utilized in the manufacture of goods meant for export. That, but for such payments of duty on inputs used in the manufacture of goods meant for exports, industrial undertaking(s) would not be entitled to the benefit of duty drawback/DEPB, notwithstanding, the Export Promotion Scheme of the Government and, therefore, there was a direct and immediate nexus between payment of duty on such inputs and receipt of duty drawback/DEPB. In this connection reliance was placed on the judgment of the Gujarat High Court in the case of **CIT v. India Gelatine and Chemicals Ltd.** reported in 275 ITR 284. Lastly, it was submitted on behalf of the appellant(s) that there was no difference

inputs and thereafter seek reimbursement on profit goods manufactured using such duty paid inputs, havi been exported. The industrial undertaking alternatively could avail of Advance Licence Scheme whereunder the industrial undertaking could import inputs to be used for manufacture of goods meant for export without payment of duty. In the case where the industrial undertaking enjoyed the benefit of Advance Licence Scheme, the profit as shown in Profit & Loss account was regarded as income derived from industrial undertaking entitled to deduction under Section 80IB of the 1961 Act without any adjustment whereas when the same industrial undertaking when it opts for duty drawback is denied the benefit of deduction under Section 80IB on the duty remitted.

9. On behalf of the appellant(s) it was submitted that Section 80IB was different from Section 80I in the sense that under Section 80IB, income derived from business of an industrial undertaking was admissible for deduction whereas under Section 80I deduction was allowable to income derived from industrial undertaking. Hence, according to the appellant(s) provision of Section 80IB was much wider in scope than Section 80I. According to the appellant(s) Section 80IB was wider than Section 80I as the Legislature intended to give benefit of deduction not only to profits derived from the undertaking but also to give benefit of deduction in respect of incomes having direct nexus with the profits of the undertaking, hence, all incomes that arose during the course of running of the eligible business would be eligible for deduction under Section 80IB, which would include income arising on sale of DEPB at premium."

9. In this case, the interest was received from customers. The AO held that the interest income was not derived from the undertaking and therefore, did not allow deduction under Section 80IA in relation to the said interest. The Tribunal, however, has allowed this claim holding that the said interest income would be incidental or attributable of business of undertaking.

10. Insofar as, interest on late payment made by the custc concerned, it has the same character as "sales" as held by Gujarat High Court in the case of ***Nirma Industries Ltd.*** vs. ***Deputy Commissioner of Income Tax***, [(2006) 283 ITR 402 (Guj).

11. No doubt in the present case, it is stated that interest from customers was charged; however, it is not clear as to whether it was on account of delayed payment. If that is the case, then the view of the Tribunal is correct in law. This aspect came up for consideration before this Court in ITA No. 248 of 2009 and other connected cases, entitled as ***Commissioner of Income Tax*** vs. ***Advance Detergents Limited*** (decided on 30.11.2009) applying the principle of liberty. It was held that the interest on delayed payment from customer against sales would partake character of price itself and would be included in the sale consideration and thus, that income would be treated as income derived from business. Following are the discussions on the subject from the said judgment:

> "12. Precisely, this very issue came up for consideration before the Gujarat High Court in the case of ***Nirma Industries Ltd.*** v. ***Deputy Commissioner of Income Tax,*** (2006) 283 ITR 402 (Guj). That was also a case where interest was received by the assessee from the debtors for late payment of the sale proceeds and the question was as to whether this interest can be treated as the income derived from the business for the purpose of Section 80-I of the Act. Answering the question in favour of the assessee, the Gujarat High Court relied upon the

case the Supreme Court had held that interest was of same nature as other trading receipts in the follow manner :-

> "The assessee is a contractor. His business is to enter into contracts. In the course of the execution of these contracts, he has also to face disputes with the State Government and he has also to reckon with delays in payment of amounts that are due to him. If the amounts are not paid at the proper time and interest is awarded or paid for such delay, such interest is only an accretion to the assessee's receipts from the contracts. It is obviously attributable and incidental to the business carried on by him. It would not be correct, as the Tribunal has held, to say that this interest is totally de hors the contract business carried on by the assessee. It is well settled that interest can be assessed under the head 'Income from other sources' only if it cannot be brought within one or the other of the specific heads of charge. We find it difficult to comprehend how the interest receipts by the assessee can be treated as receipts which flow to him de hors the business which is carried on by him. In our view, the interest payable to him certainly partakes of the same character as the receipts for the payment of which he was otherwise entitled under the contract and which payment has been delayed as a result of certain disputes between the parties. It cannot be separated from the other amounts granted to the assessee under the awards and treated as 'income from other sources".

13. The Gujarat High Court approached the issue from another angle for arriving at the same conclusion. It observed that when the assessee enters into a contract for sale of its products it could either stipulate (a) that interest at the specified rate would be charged on the unpaid sale price and added to the outstanding till the point of time of realisation, or (b) that in case of delay the payment for sale of products worth Rs. 100/- to carry the sale price of Rs. 102/- for first month's delay, Rs. 104/- for second month's delay, Rs. 106/- for third month's delay and so on. If the contention of revenue is accepted, merely because the assessee has described the additional sale proceeds as interest in case of contract as per illustration (a) above, such payment would not be profits derived from industrial undertaking, but in case of illustration (b) above, if the payment is described as sale price it would be profits derived from the industrial undertaking. This can never be, because in sum and

sale price if it delays payment of sale proceeds. In ot words, this is a converse situation to offering of c discount. Thus, in principle, in reality, the transaction remains the same and there is no distinction as to the source. It is incorrect to state that the source for interest is the outstanding sale proceeds.

14. Thus, according to the Gujarat High Court, when interest is paid on delayed payment, it can be treated as higher sale price which is converse situation to offering of cash discount because the transaction remains the same and there is no distinction as to the source. Looking from this angle, the interest becomes part of the hire sale price and is clearly *derived from* the sales made and is not divorced therefrom. It is, thus, the direct result of the sale of goods and the income is *derived from* the business of industrial undertaking.

15. Same view is expressed by various other High Courts in the following judgments :-

(i) ***Phatela Cotgin Industries (P) Ltd.*** v. ***Commissioner of Income Tax***m 303 ITR 411 (P&H)
(ii) ***Commissioner of Income Tax*** v. ***Flender Macneil Gears Ltd.***,150 ITR 83 (Cal)
(iii) ***Tata Sponge Iron Ltd.*** v. ***Commissioner of Income Tax*** 292 ITR 175 (Orissa)
(iv) ***Commissioner of Income Tax*** v. ***Indo Matsushita Carbon Co. Ltd.,*** 286 ITR 201 (Mad)

16. There is no reason to depart from the aforesaid view taken consistently by various High Courts, which is in tune with the principle laid down by the Supreme Court in ***Liberty India*** (supra). We answer this question in favour of the assessee and against the Revenue."

12. However, since it is not clear as to on what account this interest was charged, matter was to be remitted back to the AO to consider this aspect afresh. This is moreso, when in respect of interest from FDR, the Tribunal has already referred back the matter to the AO to find out as to whether the Bank had insisted for FDR as collateral security or not. While undertaking this

Court in ***Liberty India*** *(*supra*)* as well as the judgment Court cited above.

13. The assessee had also received advances from customers amounting to Rs.44,45,508/-. It was shown as income and the assessee had transferred this amount directly to the capital reserve account. On specific quarry raised by the AO, it has been explained by the assessee vide letter dated 22.08.2000 that the company had received in the past at Daman, advances from 12 customers totaling Rs.44,90,508/- for supply of DG sets. These customers failed to take delivery of the DG sets for which had paid the advances. During this year, the assessee company also refunded advances totaling Rs.45,000/- to two customer from whom advances received in the past were forfeited but upon request from the customer, these were refunded. The balance of Rs.44,45,508/- was carried over directly to the capital reserve account. The said amount has not been included in the profit and loss account or the computation of income filed. The assessee has alternatively also stated that as the sums forfeited are in respect of Daman unit, the inclusion of this amount in the income of the assessee will also qualify for deduction under Section 80IA.

become definite surplus. Thus, though the advance initially not taxable, their forfeiture rendered them to be treated as trading receipt and the amount had become a trade surplus. He thus included the said amount for the purpose of tax.

15. The CIT (A) affirmed this finding of the AO in the following words:

> "4.2 I have considered the matter. As per the facts stated on behalf of the assessee, it is not a case of unclaimed balances remaining outstanding for a long period of time and appropriated for want of claim by the creditors. It is on the contrary as case where advances have been expressly forfeited by the assessee on account of alleged breach of contract on the part of the intending purchasers. The intending purchasers have been demanding the refund of their money, and some of them have also filed suits for recovery against the assessee. However, the assessee has taken the stand that the concerned parties were themselves in default of contracts for sale, and were therefore not entitled to the refunds. The assessee has written off and appropriated their advances with the express intention of not refunding the same. The argument take by the assessee before the Department – namely that it had no right under the contracts of sale to effect the forfeiture- is contrary to its own stand visa vis (vis-à-vis *sic*.) the concerned parties. Once the repudiated the obligation to refund an advance, appropriates it by writing it off in its books, and informs the claimant accordingly, no accrued liability can be said exist thereafter. What remains at best is a contingent which may accrue in the event of an adverse court decree in a suit brought by the claimant. Till then, no liability can be said to subsist from the pint of view of the assessee. In the matter of a statutory debt, the debt subsists till the relevant stature recognizes it as such, regardless of the objections of the debtor. However, a liability under a contract accrues and subsists only if and to the extent it is admitted by the parties thereto. In the event of a dispute, what subsists is merely a claim, which can crystallize into a liability either by agreement or through a court decree.

> accrued contractual liability in respect of them exis
> The facts that the parties had made claims and had f
> suits does not alter that position. Therefore, the only
> issue that remains to consider is whether advances written
> off and appropriated by the assessee constituted its
> business income."

The CIT (A) for this purpose took support from the judgment of the Supreme Court in the case *of* ***Commissioner of Income Tax, Madurai*** vs. ***T.V. Sundaram Iyengar & Sons Ltd.*** [222 ITR 344].

16. The Tribunal reversed the opinion of the CIT(A) by simply following its earlier judgment, as is clear from the following discussion:

> "3.3.2 We have heard both the parties, perusal the records and considered the matter carefully. We have already held following decisions of Delhi Bench of Tribunal in para 3.1.3 of this order earlier that business income closely connected to the business of undertaking has to be considered for deduction u/s 80IA even if it is not directly derived from the undertaking. In this case, CIT(A) has himself held that sum of Rs.4445508/- is asseassable as business income. This income is no doubt is directly connected to the business of undertaking. We, therefore, hold that the assessee will be entitled to deduction u/s 80IA in respect of the said income. Order of CIT(A) is reversed and the claim of the assessee is allowed."

17. The Tribunal following the reasoning given in para 3.1.3 of the order. In that para, the Tribunal has held that deduction under Section 80IA of the Act will be allowable in respect of any income incidental or attributable to the business of the

the Revenue justifying the order of the CIT (A) on the judgment of the Supreme Court in the case of ***T.V. Sundaram Iyengar & Sons Ltd.*** (supra).

18. After having considered the matter, we are of the view that the order of the AO as upheld by the CIT (A) on this aspect is correct in law. Having regard to the aforesaid judgment of the Supreme Court, the amount was to be treated as trading receipt and therefore, it has to be added as income of the assessee. The transferring of this amount to the capital reserve account unilaterally by the assessee by means of book entry was not an appropriate step. The following observations in ***T.V. Sundaram Iyengar & Sons Ltd.*** (supra) needs to be highlighted:

> "…If a common sense view of the matter is taken, the assessee, because of the trading operation, had become richer by the amount which it transferred to its profit and loss account. The moneys had arisen out of ordinary trading transactions. Although the amounts received originally was not of income nature, the amounts remained with the assessee for a long period unclaimed by the trade parties. By lapse of time-barred and the amount attained a totally different quality. It became a definite trade surplus. In Jay's case it was pointed out that in Tattersall's case (1939) 7 ITR 316 (CA) no trading asset was created. Mere change of method of book-keeping had taken place. But, where a new asset came into being automatically by operation of law, common sense demanded that the amount should be entered in the profit and loss account for the year and be treated as taxable income. In other words, the principle appears to be that if an amount is received in course of trading transaction, even though it is not taxable in the year of receipt as being of revenue character, the amount changes its character when the amount becomes the assessee's own money because of

19. Once it is treated as business income, the interest questi to whether deduction could be claimed under Section 80IA of the Act. Here again, we find that CIT (A) rightly held that it was not derived from any goods or services produced by the said unit and the it arose from the absence of any goods having been produced and supplied by Daman Unit. Ratio of liberty would, therefore, be applied squarely.

20. We thus answer the question in favour of the Revenue holding that Rs.44,45,508/- received as advance from the customers and forfeited by the assessee would not be eligible for deduction under Section 80IA of the Act. Appeal stands disposed of in the aforesaid manner.

(A.K. SIKRI)
JUDGE

(SIDDHARTH MRIDUL)
JUDGE

December 23, 2009.
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