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

\+ **ITA No.167/2011**

Reserved On:09.05.2011

% **Date of Decision: 3 .06.2011**

The Commissioner of Income Tax – III .... **APPELLANT**

Through: Ms.Rashmi Chopra with Mr.Chandramani Bhardwaj, Advocates

Versus

Sadhu Forging Ltd. .... **RESPONDENT**

Through: Dr.Rakesh Gupta with Mr.Ashwani Taneja, Ms.Poonam Ahuja, Ms.Rani Kiyala and Mr.Johnson Bara, Advocates

AND

\+ **ITA No.351/2011**

Reserved On:13.05.2011

% **Date of Decision: 3 .06.2011**

The Commissioner of Income Tax – III .... **APPELLANT**

Through: Ms.Rashmi Chopra with Mr.Chandramani Bhardwaj, Advocates

Versus

Sadhu Forging Ltd. .... **RESPONDENT**

Through: Dr.Rakesh Gupta with Mr.Ashwani Taneja, Ms.Poonam Ahuja, Ms.Rani Kiyala and Mr.Johnson Bara, Advocates

CORAM:
HON'BLE MR. JUSTICE A.K. SIKRI
HON'BLE MR. JUSTICE M.L. MEHTA

1. Whether reporters of Local papers be allowed to see the judgment?
2. To be referred to the reporter or not? Yes
3. Whether the judgment should be reported in the Digest?

M.L. MEHTA, J.

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1. Both these appeals arise out of the orders of the Income Tax Appellate Tribunal (hereinafter referred to as the "Tribunal") dated 30th April, 2010 pertaining to the assessment year 2004-2005.

2. During the relevant assessment year, the assessee has shown gross-receipts, which apart from goods sales of ₹1,55,26,740/- also included scrap sales of ₹79,45,411/-, labour charges of ₹20,82,637/- and job work charges of ₹11,86,895/- and claimed to be a part of the profit for the purposes of deduction under Section 80 IB of the Income Tax Act, 1961 (for short "the Act"). The Assessing Officer held that as per the provisions of Section 80IB, which emphasize "profit and gains derived from such industrial undertaking", the assessee's industrial undertaking set up for the purpose of manufacture of steel, forging, transmission gears and parts and accessories of motor vehicles, cannot be permitted deduction on sale of scrap, job work and labour

charges as the same are attributable to the business carried on by the assessee, but not derived from the profits of industrial undertaking. He held that the aforesaid receipts may form a part of the profits and gains of the business, and can be said to be derived from other activities, but the immediate source of these cannot be an industrial undertaking. In other words, the AO held that the scrap sale charges and job work/labour charges are to be excluded for the purpose of giving effect to deduction under Section 80 IB of the Act.

3. Aggrieved by this, the assessee preferred appeal before the CIT(A) on various grounds including deductions relating to sale of scrap, job work and labour charges. With regard to the claim of deduction on sale of scrap, the CIT(A) held that the scrap generation at various stages of manufacturing process was part of the manufacturing activity of an industrial unit and thus represented profits and gains derived on this account were from the industrial undertaking. Consequently, it recorded a finding in this regard in favour of the assessee and allowed its appeal. The Revenue carried the matter in appeal before the Tribunal, which came to be dismissed vide the impugned order, holding that scrap was generated through the process of manufacturing and thus was a part and parcel of manufacturing process of industrial undertaking, and thus profits on sale of scrap

represented profits and gains derived from industrial undertaking. This was based on the premise that there was an immediate and proximate connection with the manufacturing process of industrial undertaking. The Revenue is in appeal against this part of the impugned order in ITA No.351/2011.

4. With regard to the claim of deduction on job work and labour charges, CIT(A) disallowed the appeal of the assessee and held that the job charges not derived from the exports are to be categorized as independent income and has to be deducted from gross profits to calculate profits derived from the exports. He, however, held that the assessee was eligible for deduction under Section 37 on ₹6,53,906/- which would work out to ₹1,96,172/- on account of expenses relating to earning of these job work, labour charges. He accordingly directed the AO to reduce the claim of the deduction under Section 80IB of the Act to an amount of ₹1,96,172/-. The assessee preferred appeal against the order of the CIT(A), which came to be allowed by the impugned order by the Tribunal, who held that job works/labour charges income received by the assessee, by utilizing its plant and machinery installed in the undertaking, gave rise to income which had a direct nexus with the assessee's industrial undertaking, and thus entitled to claim of deduction under Section 80IB of the Act. The

Revenue is in appeal against this part of the impugned order in ITA No.167/2011.

5. ITA 167/2011 was admitted on the following substantial questions of law:

(i) Whether income received from job work/labour charged on work done based on material supplied by the customers qualifies for deduction under Section 80IB of the Income Tax Act, 1961.

(ii) Whether income received from job work/labour charges on work done on material supplied by the customers is profits derived from industrial undertaking to be eligible for deduction u/S 80IB of the Income Tax Act, 1961.

6. ITA 351/2011 stands admitted on the following substantial question of law:

(i) Whether on the facts and in the circumstances of the case, the ITAT erred in law and on merits in holding that scrap sale generated is eligible for deduction u/s 80IB of the Income Tax Act, 1961?

7. With the consent of the counsel for the parties, we have heard the matter finally. To answer the questions in both the appeals, we need to consider, firstly, as to whether the scrap, generated at various stages of manufacturing process, was part of manufacturing activity of the industrial unit and thus represented profits and gains derived from the industrial undertaking on this

account were entitled to deduction under Section 80IB. Secondly, as to whether the receipts by the assessee on account of job work and labour charges are attributable to business carried on by it of the industrial undertaking.

8. Section 80IB of the Act provides for deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings. Sub-Section (2) thereof provides for deduction to any industrial undertaking, which fulfills all the following conditions, namely:

> "S.80-IB (2)
>
> (i) ....
>
> (ii) .....
>
> (iii) It manufactures or produces any article or thing, not being any article or thing specified in the list in the Eleventh Schedule, or operates one or more cold storage plant or plants, in any part of India:"

9. From a plain reading of this Section, it would be seen that the only essential requisite is that the eligible industrial undertakings should be carrying out manufacture or production of articles or things. This may take us to the question as to whether the activity of the assessee was to be that of manufacture or production of article or thing as envisaged under this clause (iii) of sub-Section (2) of Section 80-IB. The industrial undertaking, set up by the assessee, was for the purpose of manufacture of

steel forging, transmission gears and part and accessories of motor vehicles and the scrap of these items was stated to be a bye-product of manufacturing process. Learned counsel for the assessee explained in detail the process involved in forging and in this regard he drew our attention to the finding of the Tribunal based on the records that the assessee was involved in manufacturing of forging which involved purchase of steel, cutting the same, making of forging parts, giving heat treatment and machining. Die making was stated to be the primary process and is a separate industry by itself. It was noted, and rightly so, that each of the above process could be done in separate industrial undertaking, whereas assessee had undertaken all these processes in its units. The issue was also that the assessee was doing these works on job basis for other undertakings, by getting the raw material from them. When the assessee was entitled to claim exemption in respect of income derived from such processes doing for itself, we do not see any reason as to why he would not be entitled to so merely because the raw material component was being supplied by other customers and for whom the assessee was doing the job. In fact, deduction under Section 80-IB is given on the profits derived from the manufacturing process, being undertaken by the assessee which qualify for deduction.

10. The heat treatment is one of the processes through which the forgings are given the desired temperature and then cooled in different manner which results in changing the mechanical properties desired by the customers. We are given to understand that there are various industrial undertakings which are specialized only in the heat treatment processes. Learned counsel for the assessee informed us, without refutation from the Revenue, that the forging involves heating to a desired temperature and then soaking the material at that temperature until the structure become uniform throughout the section and then cooled in a different manner to achieve the desired mechanical and molecular bonding properties. The cooling of the material at some predetermined rates causes the formation of desired structure within the metal for the desired properties with the aim (i) to improve the mechanical property such as tensile strength, hardness, deductibility, shock resistance, etc. (ii) improve machinability, (iii) increase resistance to heat and corrosion (iv) relieve stresses developed due to hot and cold working, (v) modify electrical, magnetic & molecular bonding properties, etc. The heat treatment toughens the forged part for being used as automobile parts. The process of heat treatment is absolutely essential for rendering them marketable. Without the heat treatment, the material is not fit for automobile

industry. The learned counsel relied upon ***CIT v. Tamil Nadu Treatment & Fetting Services (P) Ltd.***, 238 ITR 540 (Mad) wherein activity carried out by the assessee consisted of receiving from its clients untreated crankshafts, forgings, castings, etc. and subjecting them to heat treatment in order to toughen them to the requisite standards, so that they could be sold in the market. The activity was held to be manufacturing and entitled to claim deductions. Similarly in the case of ***CIT v. Tamil Nadu Heat Treatment & fetting Services (P) Ltd.,*** 238 ITR 529 (Mad), it was held that the process of heat treatment to crankshaft, etc. were absolutely essential for rendering it marketable. Automobile parts, as crankshafts, need to be subjected to heat treatment to increase the wear and tear resistance to remove the inordinate stress and increased tensile strength. The raw untreated crankshafts and the like can never be used in an automobile industry. Thus, in the crankshafts subjected to the process of heat treatment, etc. a qualitative change is effected, to be fit for use in automobiles, although there is no physical change in them. In such state of affairs, it cannot at all be stated that the crankshaft, subjected to heat treatment, etc., cannot at all change the status of new products of different quality for a different purpose altogether. In this view of the matter, the activities of the assessee in relation to

raw or untreated crankshafts being subjected to heat treatment, etc., is definitely a "manufacturing activity" entitling it to claim "investment allowance" under S.32A.

11. In the case of ***India Cine Agencies v. CIT***, 308 ITR 98 (SC), the conversion of jumbo rolls of photographic films into small flats and rolls in desired sizes amounts to manufacture or production eligible for deduction under Sections 80HH and 80I. In another case titled ***CIT v. Oracle Software India Ltd.,*** 320 ITR 546 (SC), it was observed that if an operation/process renders commodity or article fit for use for which it was otherwise not fit, the operation/process falls within the meaning of the word "manufacture" – in the instant case, the assessee undertakes an operation which renders a blank CD fit for use for which it was otherwise not fit – by the duplication process undertaken by the assessee, the recordable media which is unfit for any specific use gets converted into the programme which is embedded in the master media and, thus, blank CD gets converted into recorded CD by an intricate process – Said supplicating process changes the basic character of a blank CD, dedicating it to a specific use – therefore, processing of blank CDs constitutes manufacture in terms of S.80-IA(12)(b) r/w explanation to S.33 B – Marketed copies of CDs being goods, the process by which they become

goods certainly falls within the ambit of S.80-IA(12)(b) r/w explanation to S.33B.

12. Thus, in view of above, we have no hesitation in arriving at the conclusion that the activity of forging was "manufacturing" within the ambit of Section 80IB. It was immaterial that the assessee was doing the job of forging also for customers and was charging them on job-work basis or on the basis of labour charges. It will still be qualified as carrying eligible business under Section 80IB. Same is the ratio of the decisions in the cases of (i) ***Commissioner of Income Tax v. Metalman Auto (P) Ltd.,*** (2011) 52 DTR (P&H) 385; (ii) ***Commissioner of Income Tax v. Vallabh Yarns (P.) Ltd.,*** (2011) 51 DTR (P&H) 236; (iii) ***CIT v. Impel Forge & Allied Industries Ltd.***, (2010) 326 ITR 27 (P&H), (iv) ***CIT v. Rane (Mad) Ltd.,*** 238 ITR 377 (Mad), and (v) ***Dy. CIT v. Harjivandas Juthabhai Zaveri & Another***, 258 ITR 785 (Gujarat).

13. Keeping in view the activities of the assessee in giving heat treatment for which it had earned labour charges and job-work charges, it can thus be said that the appellant had done a process on the raw material which was nothing but a part and parcel of the manufacturing process of the industrial undertaking. These receipts cannot be said to be independent income of the manufacturing activities of the undertakings of the

assessee and thus could not be excluded from the profits and gains derived from the industrial undertaking for the purpose of computing deduction under Section 80IB. These were gains derived from industrial undertakings and so entitled for the purpose of computing deduction under Section 80IB. There cannot be any two opinions that manufacturing activity of the type of material being undertaken by the assessee would also generate scrap in the process of manufacturing. The receipts of sale of scrap being part and parcel of the activity and being proximate thereto would also be within the ambit of gains derived from industrial undertaking for the purpose of computing deducting under Section 80IB.

14. From our above discussion, we answer the questions in favour of the assessee and against the Revenue in both the cases and consequently, dismiss both the appeals.

M.L.MEHTA
(JUDGE)

A.K. SIKRI
(JUDGE)

June 3, 2011
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