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

% **DECIDED ON: 05.03.2015**

\+ ITA 220/2007 & ITA 232/2007, C.M. No.1165/2013

COMMISSIONER OF INCOME TAX DELHI ..... Appellant
Through: Mr. Rohit Madan, Sr. Standing Counsel with Mr. Ruchir Bhatia and Mr. P. Roy Choudhary, Advocates.

versus

TONY ELELCTRONICS LTD. ..... Respondent
Through: Mr. Satyen Sethi with Mr. Arta Trana Panda, Advocates.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE R.K. GAUBA

S.RAVINDRA BHAT, J. (OPEN COURT)

1. The following questions of law are urged: -

1. Did the ITAT fall into error in holding that the claim under Section 80HH in respect of Namoli Unit and 80I in respect of Malanpur Unit were admissible (common to ITA Nos.220/2007 & 232/2007)?

2. Did the ITAT err in regard to the assessee's depreciation claim in respect of Namoli Unit (common to both appeals ITA 220 & 232/2007)?

3. Was the suppression of sale to the tune of Rs.1.79 crores as alleged by the Revenue for AY 1994-95 (ITA 232/2007) justified?

4. Did the ITAT fall into error in its findings of loss with

regard to the Unit No.1 at Noida? (in ITA 232/2007)

5. Did the ITAT fall into error in respect of the claim for foreign exchange fluctuation made by the assessee?(in ITAT 232/2007)

Question nos.1&2

2. The brief facts are that the assessee engages itself in the manufacturing, *inter alia,* of cassettes. At the relevant time, i.e., 1994-95 and 1995-96, the assessee had owned five production units. Two were located at Noida; one at Delhi and two at Namoli and Malanpur (UP). The assessee's production process entails manufacturing of Audio Magnetic Tapes (AMT) in bulk - an activity carried out in the two Noida units. These articles were thereafter transported to the other Units - in the present instance Namoli and Malanpur where final products - marketed by the assessee were assembled. The assessee had claimed the benefit of Section 80HH and 80I in respect of Namoli Unit and Section 80IA in respect of Malanpur Unit which had been granted from the years 1991-92. In the course of assessment for AY 1994-95, based upon the assessee's returns, the AO formed an opinion that no manufacturing activity was carried out in Namoli and Malanpur. This, he surmised based upon (a) the loss declared by the Noida Unit, (b) the transfer of tapes manufactured in the Noida units and the fact that manufacturing was not carried on in the Malanpur and Namoli units and (c) that the assembling of the articles produced at the Noida Unit did not amount to manufacture and that there was other material to indicate functional integrality of all the units.

3. On the basis of these findings, the AO disallowed the claims under Section 80HH, 80I and 80IA (the latter being in respect of Malanpur unit) and brought to tax the deductions claimed. The assessee appealed to the CIT (A) who, in his elaborate order, considered the entire materials on record with respect to the different nature of activities carried on in the units in question; the lack of evidence to show that goods sold or transferred to the Namoli and Malanpur units were not based on market price; the overwhelming evidence establishing that both units had machinery, were filing sales tax and excise returns and were also employing workers; and concluded that the claim under Sections 80HH and 80I and 80IA respectively were justified in the given circumstances of the case. The CIT(A), however, remitted the matter with respect to certain adjustment indicated by him in the order.

4. The decision of the CIT (A) was appealed against by the Revenue. The ITAT by its own elaborate order considered the matter and the entire factual matrix and affirmed the order of the CIT (A).

5. Regarding question no.1, the Revenue urges that findings of the CIT (A) and the ITAT in this case with respect to the units being separate and not functionally the same are erroneous and contrary to the record. It was emphasized that mere assembling of tapes would not constitute manufacturing. Learned counsel relied upon the decision in *Krishak Bharti Cooperative Ltd. v. Deputy Commissioner of Income Tax* (ITA 1248/2010, decided on 24.07.2013) to urge that the expression "derived from" is narrower in connotation as compared to the expression "attributable to" which occurs in other provisions.

It was submitted that ownership by the assessee of an industrial undertaking, has to necessarily be established. It was also contended that the losses claimed by the Noida unit and profits claimed correspondingly by the Malanpur and Namoli units also should disclose that there was a functional integrality and that the latter units which claimed exemption were in fact entirely derived from the manufacturing activity carried on by the Noida unit.

6. The AO's findings in regard to the functionality are extracted below: -

> *A) The expenditure pertaining to vehicles have not been debited by the units having ownership of their on. The use of the vehicles is not confined to the units having ownership. But the depreciation is claimed by the owner units declared.*
>
> *B) The employees of one unit are working for the other unit. But their salary is debited in the unit of their enrolment. Some time, travelling expenses have been paid to the non employees of the company namely by the Malanpur Unit. In the Malanpur unit, payments have been made for 65 trips in respect of persons who are not employees of Malanpur Unit. This expenditure amounted to Rs.62,659/-. Similarly unit-II has claimed expenditure in respect of 5 persons who are not employees of unit-II.*
>
> *C) No separate bank account for each and every unit except Malanpur are maintained. The profits and the accumulated funds of any unit is not marked separately, whereas the company makes such demarcation in respect of inter transfer of various raw materials. In order to arrive the correct and factual income of any unit, it is necessary to account for the utilization of funds also.*
>
> *However, it would not amount to change the ultimate final results of the company as a whole. It is also relevant to note that even the day to day fund base need of other units are also monitored by unit-II for all the purposes except for availing deductions. The company admits that all the units*

are one and the same for all other purposes i.e. before the sales tax dept. and other dept.

D) *Before the sales tax authorities of the Uttar Pradesh, the company declares the various units as branches and there by one assessment of the company is made by them by virtue of having one registration number. If all the units are declared independent the assessee company would have to take separate registration of unit. But it was not so.*

E) *Unit-II has acted as mediator even for procurement of raw material by a so called independent unit namely Namoli and Malanpur. This fact is evident from the information that all the audio components worth Rs.36.50 lacs have been transferred to Malanpur Unit and audio components worth Rs.128.61 lacs to Namoli Unit. Though unit-II has not manufactured even single component (refer page 61 and 62 of Report of S.A.)*

F) *Material on loan basis is transferred to M/s SCI LTD by Unit-II and vice versa. While passing such entries there is no actual or real transfer of money. Similarly material on loan has also been given by unit-I also. This again proves that no real profit could be arrived for separate units."*

7. The CIT (A), however, went into the records and materials placed before him rather elaborately. These materials included *inter alia* the employees' details in the form of 14 reports and documents including factory inspection reports for the period 1992-97. These reports as well as other materials established that the units in question in Malanpur and Namoli were employing substantial number of workers - between 95-108; the electricity billing patterns for the said period and the amounts paid were also taken into consideration. Furthermore, the CIT (A) noticed that the sales tax assessments for the period 1991-96 also substantiated the assesee's claim of second manufacturing activity for the said two units. The CIT (A) also took

note of the fact that the AMT produced and marketed by the assessee became excisable and that the application had been made on 5.8.1997 to the Assistant Commissioner of Excise, Noida claiming Modvat under Rule 57H. There was physical verification of the inventory at Namoli and the Excise Department had in fact granted credit to the assessee under the Modvat scheme. Furthermore, other co-lateral material in the form of show cause notice issued by the Excise Department and the correspondence with the Sales Tax Department, bonus registers, and returns of statistics filed with the Government authorities etc. were all taken into consideration.

8. The CIT (A) also extracted charts indicating number of workers engaged by the assessee based upon the records produced by it; these are found at paragraph 11 of the order. The CIT (A) made a detailed comparison of the price of similar goods manufactured by other producers. A chart was prepared; the same has been reproduced in paragraph 2.23 of the CIT (A)'s order. Based upon these materials, the CIT (A) adjusted profits of the various units in the following terms: -

Particulars	*Unit-I*	*Unit-II*	*Unit-IV*	*Unit-V*	*D.Ganj*	*Total*
			(NAMOLI)	*(MALANPUR)*		
Turnover in Rs.	*5600627*	*66835883*	*50499228*	*11992944*	*129820*	*135158503*
Turnover %	*4*	*50*	*37*	*9*	*0*	*100*
Profit (before taxation) as per profit & loss account	*(7786038)*	*(6712448)*	*22368626*	*1232723*	*(8651)*	*9094212*
Add: selling, distribution and administrative expenditure,	*1599985*	*2882673*	*193865*	*679067*	*8681*	*5364271*

excluding loss due to foreign exchange fluctuation						
Add Financial charges	*77588*	*692726*	*-*	*9484*	*-*	*779798*
TOTAL	*(6108465)*	*(3137049)*	*22562491*	*1921274*	*30*	*15238281*
Less: Pro-rata selling, distribution and administrative expenses and financial charges on the basis of turnover.	*254595*	*3042788*	*2295607*	*545178*	*5901*	*6144069*
Less: excess profit as per para 3.7 below				*295000*		
Adjusted profit	*(6363060)*	*(6179837)*	*20266884*	*1081096*	*(5871)*	*9094212*

The Assessing Officer is therefore directed to allow deductions u/s 80-HH and 80I in respect of the Namoli unit on a profit of Rs.20266884/- and in respect of Malanpur unit on a profit of Rs.1081096/-. This direction is however subject to one qualification. Since the sale bills of comparable producers have been filed in the course of appeal proceedings and the Assessing Officer has not had the opportunity to examine them, the Assessing Officer may do so before giving effect to this order. In case the Assessing officer finds that the sale bills of comparable producers filed by the assessee do not indicate the correct market prices of the relevant products, he may ascertain the correct market prices of those products independently, and may make further necessary adjustment to the profits of the Namoli and Malanpur units as worked out in the chart above.”

9. The ITAT concluded that assembling of cassettes from finished

components amounted to manufacturing and held as follows: -

> *"21. On this question, we are of the view that the blank audio or video cassettes assembled from various components is a distinct and separate marketable commercial commodity and therefore, the assembly of the components amounts to manufacture. The CIT (A) does not appear to have examined this question in details presumably because he addressed himself in great details, to the question whether the Namoli unit did actually function during the relevant previous year and produced cassettes. It seems to us that implicit in the findings that the Namoli unit did function during the relevant previous year, is the finding that the assembly also amounts to manufacture. Even otherwise, the finding can be supported by the fact that the central excise authorities did consider the production of cassettes as a manufacturing activity as can be seen from the fact that audio cassettes became an excisable product from 28.02.1997. Though this date falls outside the accounting year relevant to the assessment year 1995-96 it supports the findings that the activity amounts to manufacturing activity and was brought into the excise net only from February, 1997. We, therefore, hold that the assembly of the cassettes from the finished components does amount to manufacturing and agree with the CIT (A)."*

10. The ITAT also affirmed the findings with regard to the actual functioning of the two units which claimed exemptions during the relevant previous years in the following terms: -

> *"In support of the contention, that these two units actually functioned during the relevant previous year, the assessee adduced copious materials and evidence before the CIT (A) which were sent to the AO by the CIT (A) by letter dated 13.04.1999 and he was asked to give his comments in respect of them. The A.O. gave his*

comments by letter dated 16.04.1999 stating that the evidence had been created by the assessee and also questioning the claim of the assessee by pointing out that the Namoli unit did not have a power connection. The CIT (A) took into account the evidence and also comments of the AO and proceeded to examine the matter closely. He recorded his findings as under: -

(i) the Namoli unit did have an electricity connection. This is clear from the electricity bills issued by UP State Electricity Board in respect of the Period 26.03.1990 to 02.12.1998 and includes the accounting year under consideration. ii) the assessee also produced photographs of the electricity cable, electricity pole, energy meter, tube box etc., iii) the Namoli unit mainly relied on captive power generation and incurred a total expenditure of Rs.2,97,360/- on the purchase of HSD and mobile oil during the year, iv) the assessee also filed a copy of an order dated 06.03.1998 passed by the Commissioner of Sales Tax, Lucknow in which, after referring to the survey report and the evidence produced by the assessee he held that there was no proof "that the production at the unit under reference was suspended continuously for more than six months nor was it proved that the sales tax exemptions was misused by the assessee", v) the assessee had filed several items of evidence to show the crossing of goods through the sales tax barrier and the seal affixed on all invoices of components imported from Noida and Delhi into the Namoli unit. The AO had commented that this evidence had been created by the assessee by taking the goods to the sales tax checkpost, getting the invoices stamped and then taking the goods back to Noida instead of taking them to Namoli. This allegation of the AO was not supported by any evidence and the CIT (A) himself felt that it would be impossible for anyone to collude with an entire Government Department regularly for seven years and that the comment had been made in a sweeping and

an incredible manner without any evidence. vii) Several Government Departments such as the Department of Industries, U.P., the Additional Labour Commissioner, Ghaziabad, Director of Factories, Meerut etc., have conducted physical inspection of the Namoli unit under different laws and have filed reports pointing out discrepancy in the functioning of the assessee's factory. Some inspection reports referred to the consumption of electricity for the purpose of manufacturing and also referred to the fact that 162 employees were found at the time of inspection out of 199 employees on the pay roll. Some reports also mention the number of employees with the aid of power. There were enquiries about the storage of chemicals and gases in the factory at Namoli. The Central excise authority had also conducted physical verification of the inventory available at Namoli on 28.02.1997 and allowed modvat benefit to the assessee. Various other evidence such as the attendance register, bonus register, factory act register, employment exchange returns, returns of statistics etc. have also been maintained by the assessee. All this evidence is adverted to by the CIT (A) between pages 23 & 31 of his appellate order, viii) The Inspector of income-tax had submitted a report dated 18.04.1998 in which he has stated that Namoli unit was not functional. The assessee's claim was that the Inspector never visited the unit and in support of the claim the visitors register was produced before the CIT (A). The assessee also challenged the Inspector to mention the name of the guard, who had allegedly told him that no production was carried on in the Namoli unit. The names of the Guards present on 18.11.1998 at the Namoli unit were furnished to the CIT (A) and the duty register was also produced. The Inspector was not able to mention the name of the guard in his report. The assessee also produced the guards who were on duty on the date of inspection before the CIT (A) and the CIT (A) called upon the inspector to identify the guard, who had stated

that no production was carried on in the unit. The Inspector did not turn up before CIT (A) to do so. The CIT (A), therefore, did not attach much credence to the report of the Inspector and rejected the same as unsubstantiated.

23. On the basis of the above findings, based on the material produced before him, the CIT (A) concluded that both the Namoli and Malanpur unit did function during the relevant accounting year and employed the requisite labour to produce the articles which resulted in the profits. He accordingly directed the AO to allow the deduction. On a careful consideration of the findings of the CIT (A) and the material placed before him, which were all compiled in the paper book filed before us, we are of the view that no interference is required in his decision. No material or evidence was produced before us to contradict the findings of the CIT (A) or to impeach the authenticity of the evidence adduced before the CIT (A). The findings of the CIT (A) having been passed on the unimpeachable evidence adduced before him, which had also being scrutinized by the AO and commented upon, we see no reason to upset the finding. We, therefore, uphold his decision that the units did actually functioned during the relevant previous year."

11. It is thus evident that both the CIT (A) and the ITAT carried out an elaborate factual analysis about the existence of manufacturing activity at Namoli and Malanpur. Based on this analysis, these fact finding authorities concurrently ruled in favour of the assessee. In contrast, the AO - as is evident from the extracts of his order - based his decision entirely on assumptions. Those assumptions stemmed out of his belief that the claim for losses of the Noida unit could not co-exist with the profits derived from the Namoli and Malanpur units.

We also noticed that the AO's order did not take into account the materials which were ultimately considered by the CIT (A). The latter, in fact, took care to call for the AO's comments during the course of the appellate proceedings. The material in the form of factory register, employee's rolls, periodic sales tax and excise returns, evidence of electricity payments etc. was decisive enough for both the CIT (A) and ITAT to be satisfied that in fact the two units in question functioned.

12. This Court, therefore, is of the opinion that there is no infirmity with the factual findings of the ITAT in the assessee's favour.

13. So far as the question whether the activity carried out in Malanpur and Namoli amounted to manufacturing goes, the fact that the assessee claimed and was granted modvat credit under Rule 57H of the Central Excise Rules at the relevant time itself is indicative that for purposes of excise, "the assembling of cassettes amounted to manufacture". It goes without saying that the goods in question, i.e. Audio Video Tapes are manufactured in bulk - as in the present instance in Noida, which in turn constitute the raw materials for the ultimate assembly of the marketable products into cassettes in which several intervening stages would be involved. These would be cutting of the tapes into requisite levels, their placement in cassettes shells, packaging of such finished cassettes and labelling etc. In these circumstances, the Revenue's argument that no manufacturing activity was involved in the assembling of cassettes is unsustainable. We also hold that the decision in *Krishak Bharti (supra)* is only an authority for the proposition that the expression "derived from", is

with respect to the activity and not the ownership of the unit. This Court is of the opinion that the said decision has no relevance in the circumstances of the present case.

14. Having regard to the above conclusion, the first question is answered against the Revenue and in favour of the assessee.

15. The second question framed in these cases pertains to the depreciation claims for the Namoli unit. In view of the concurrent findings of the CIT (A) and the ITAT that in fact Namoli unit actually functioned during the relevant year, the depreciation was correctly allowed.

16. This question, too, is answered in favour of the assessee and against the Revenue.

Question No.3 - Alleged suppression of sale

17. In 1993-94, one of the Noida units transferred 5000 pieces of VMT to the Malanpur Unit for Rs.97 per piece including the excise duty component of Rs.55.05. The Malanpur unit had moved 1960 video cassettes in the two years in question, i.e., 1993-94 and 1994-95. The reduced excise duty led to fall in the price of video cassettes. Consequently, the average market price also went down. In order to compensate the Malanpur unit, M/s Super Cassettes Industries purchased video cassettes at the price of Rs.104. The concurrent findings of fact are that there was no suppression of sale prices since 83% of the total video cassettes sales was exported at an average price of Rs.27.79/-. The CIT (A) held that these exports are substantial enough and that the allegations that there was under-invoicing of exports by the assessee could not be validly

returned. These findings were affirmed by the ITAT in paragraph 41 -43 of the impugned order. Again being entirely factually in nature, the Court sees no reason to interfere with them. This question is accordingly answered against the Revenue and in favour of the assessee.

Question No.4

18. As far as the loss claimed, i.e., of Rs.66,25,885/- by the assessee in respect of Noida unit goes, the AO disallowed it in entirety. The CIT (A) in his order - as was noticed earlier, made an elaborate and detailed analysis of the facts and held that even if total production and sales were ignored, the fixed cost attributable to the unit were substantial. These costs were in the nature of the employees' wages, bonus, compensation, electricity, water charges, repairs and maintenance etc. Consequently, the disallowance to the extent of Rs.26,80,087/- was sustained. What was allowed to the assessee was Rs.39,45,798/-. The facts in respect of this were noticed in paragraph 44 of the ITAT's order which is reproduced below: -

> *"44. The assessee is engaged in the production of audio magnetic tape (AMT) since 18.07.1985 in unit-I. From the details of the production relevant to the financial year 1985-86 relevant to the assessment year 1986-87 and all the subsequent years (see table in para 6.1 of the order of the CIT (A), the AO noted a decline in the production of AMT which altogether stopped in the assessment year 1994-95 and later on picked up and reached a figure of 1175 million running meters in the financial year 1997-98. The assessee had explained that the production at the unit was stopped with effect from 01.04.1993 for major repairs and renovation and regular production was resumed only from 06.05.1996. During*

the above period of more than 3 years the following repairs and additions were carried out to the plant & machinery of unit no.-II.

Fin. Year	*1993-94*	*1994-95*	*1995-96*	*1996-97*	*Total*
Repairs (Rs.)	*1963265*	*599619*	*404886*	*2935220*	*5902990*
Addition (Rs.)	*Nil*	*2060156*	*5346*	*365484*	*4610986*

It was further stated that during the accounting years relevant to the assessment year 1995-96 and 1996-97 there was only trial production of the plant resulting in 81 million running meter and 45 million running meters of AMT were being produced. Details of the trial production during these years were furnished by the assessee. For the assessment year 1995-96 despite the stoppage of production the assessee continued to incur expenditure under various heads such as raw materials, manufacturing expenses, excise duty, selling & distributing expenses, depreciation, financial charges etc., aggregating to Rs.133.87 Lakhs. The gross income came to Rs.56.00 Lakhs including the income from production of magnetic tapes. The result was a loss of Rs.77.86 Lakhs in the Unit-I."

19. The ITAT noticed that after the unit was started again on 6.5.1996, the electricity connection of unit-2 was utilized since the unit's initial connection was dis-connected on 25.7.1994. The position, therefore, was that in February and March, 1995 when the assessee had conducted trial production, the unit had only six workers. Noticing that the AO disbelieved all these facts and after consideration the rival claims (since the Revenue and the assessee preferred appeals on this aspect), the ITAT agreed with the findings

of CIT (A) in view of the circumstance that electricity connection was in fact surrendered on 25.7.1994 and, therefore, it was not clear how trial production could have commenced in February/March, 1995. In view of these findings, the ITAT held as follows: -

> *"50. However, we also agree with the CIT (A) that the entire book results cannot be rejected u/s 145 (2) merely because the trial production was not proved. In our opinion, he has rightly re-cast the profit & loss account of the unit and has allowed the expenditure which is in any case allowable, the details of which have already been noticed. On an overall survey of the order the CIT (A) and the material on which his conclusions are based we are unable to say that he has taken an erroneous view of the matter. We accordingly affirm his decision to allow the loss to the extent of Rs.39,45,798/- and to sustain the balance loss of Rs.26,80,087. Thus both the grounds taken by the department and those taken by the assessee in respect of this point stand dismissed."*

20. Apart from stating that the findings are erroneous, the Revenue has not pointed out either perversity or unreasonableness or that any of these findings were not based upon the inference that could not have been drawn in the circumstances of the case. Consequently, no substantial question of law arises.

Question no.5

21. On account of foreign exchange fluctuation, the purchase costs of raw materials increased by Rs.29,36,000/-. The AO was of the view that this could not be allowed as revenue expenditure. The CIT (A) and ITAT reversed that finding. It is not disputed that this head of expense was correctly treated as falling in the revenue stream in

view of the decision of this Court in *CIT vs. Woodward Governor India P. Ltd.* (2007) 294 ITR 451 Del. That decision was affirmed by the Supreme Court in *CIT v. Woodward Governor India (P.) Ltd.* 312 ITR 254 (SC). The question of law, therefore, is answered against the Revenue and in favour of the assessee.

22. ITA Nos.220 & 232/2007 are accordingly dismissed.

S. RAVINDRA BHAT
(JUDGE)

R.K. GAUBA
(JUDGE)

MARCH 05, 2015
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