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

Reserved on: 25th November,2009

Date of Decision: 23rd December, 2009

\+ **ITA 1154/2009 & ITA 1204/2009**

COMMISSIONER OF INCOME TAX (CENTRAL)-III DELHI
..... Appellant

Through: Mr. Sanjeev Sabharwal, Adv.

versus

NESTOR PHARMACEUTICALS LIMITED ..... Respondent

Through: Mr. C.S. Aggarwal, Sr. Adv. with
Mr. Prakash Kumar, Adv.

And

ITA 160/2008, ITA 161/2008 & ITA 793/2009

SIDWAL REFRIGERATION IND. LTD. ..... Appellant

Through: Mr. R.M. Mehta with Mr. Bharat
Beriwal, Advs.

versus

DEPUTY COMMISSIONER OF INCOME TAX, CIRCLE-8(1)
..... Respondent

Through: Mr. Sanjeev Sabharwal, Adv. in
ITA No. 160 & 161/2008.
Ms. Sonia Mathur, Adv. in
ITA No. 793/2009.

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

1. Whether reporters of local papers 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?

J U D G M E N T

A.K. SIKRI, J.

1. ITA Nos. 1154/2009 and 1204/2009 were heard on 25th November, 2009 and judgment reserved. Within few days other three ITAs were heard on 9th December, 2009. Though the assessees are different in the two sets of appeals, questions of law are common. In fact, ITA Nos. 1154/2009 and 1204/2009 are filed by the Revenue as the Income Tax Appellate Tribunal (ITAT) has decided the matter in favour of the assessee. On the other hand, in other appeals it is the assessee who is the appellant and is aggrieved by the order of the ITAT. For this reason we deem it proper to decide all these appeals by one common judgment. Of course at the same time we shall take up both sets of appeals separately for discussions.

ITA No. 1154/2009 and ITA No. 1204/2009

2. The assessee M/s Nestor Pharmaceuticals Limited is in the business of manufacturing of pharmaceuticals formulations in bulk drugs and supplying the drugs to the Government hospitals, institutions besides selling the product in domestic and foreign markets. It is claiming depreciation on plant and machinery for benefit under Section 80IA/80IB of the Income Tax Act(in short 'Act'). The assessee had carried out trial production from 20th March, 1998. On that basis the Assessing Officer treated assessment year 1998-99 as the initial year for benefit under the aforesaid provision. Since this benefit is allowable for five years, according to the Assessing Officer, this benefit as admissible from assessment years 1998-99 to assessment year 2002-03. The assessee on the other hand was

claiming benefit from assessment year 1999-2000 to assessment year 2003-04. The ITA No. 1204/2009 refers to assessment year 2003-04. For this reason, in respect of this assessment year, the benefit was entirely disallowed. The Commissioner of Income Tax (Appeals) [CIT(A)] confirmed the order of the Assessing Officer but the ITAT has reversed that order holding that since Section 80IA/80IB of the Act being beneficial legislation, the benefit should be extended to the assessee. It further held that as on 20th March, 1998 only trial production started which is different from commercial production and benefit of that Section would be allowed in the year in which commercial production started i.e. in the assessment year 1999-2000 and, therefore, would be extendable up to the assessment year 2003-04.

3. Section 80IA was inserted by the Finance Act 1991 w.e.f. 1st April, 1991. It was amended from time to time. Its legislative history is taken note of by the Supreme Court in the case of ***Liberty India*** vs. ***Commissioner of Income Tax***, ***317 ITR 218***. However, it is not necessary to go into the same. Since we are concerned with assessment year 1998-99 and 1999-2000, we shall have to take into consideration the provision which existed as on that date. Sub-section (1) of Section 80IA reads as under:

> "**(1)** Where the gross total income of an assessee includes any profits and gains derived from any business of an industrial undertaking or an enterprise referred to in sub-section (4) (such business being hereinafter referred to as the eligible business), there shall, in accordance with the subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction from such profits and gains of an amount equal to hundred per cent of profits and gains derived from such business for the first five assessment years commencing at any time during the periods as specified in sub-section (2) and thereafter, twenty-five

per cent of the profits and gains for further five assessment years:
Provided that where the assessee is a company, the provisions of this sub-section shall have effect as if for the words "twenty-five per cent", the words "thirty per cent" had been substituted."

4. There is no quarrel that the assessee qualifies as the industrial undertaking as specified in the said Section for the purpose of deriving benefit of the said provision. This provision allows deduction from profits and gains of an amount equal to hundred per cent of profits and gains derived from such business for the first five assessment years commencing at the time during the periods as specified in Sub-section (2) and the dispute is as to which are the first five assessment years. These five years are to commence at any time during the periods as specified in Sub-section (2). Sub-section (2) mentions "beginning from the year in which the undertaking or the enterprise develops and begins to operate any infrastructure facility……." The provision which existed at that time included Sub-section 12 and clause (c) thereof defined "initial assessment year" in the following manner:

"(12)……
(c)"initial assessment year" –
(1) in the case of an industrial undertaking or cold storage plant or ship or hotel, means that assessment year relevant to the previous year in which the industrial undertaking begins to manufacture of produce articles or things, or to operate its cold storage plant or plants or the ship is first brought into use or the business of the hotel starts functioning;"

5. The initial assessment year, for the purpose of Section 80IA, is the assessment year relevant to previous year in which the "industrial undertaking begins to manufacture or produce articles or things". In

the present case, as noted above, the trial production began on 20th March, 1998 in its Goa plant as per the details given in the audit report furnished by the assessee along with its return of income for assessment year 2003-04 and 2004-05. According to the Assessing Officer this amounted to manufacture of its products on the date which means during the previous year relevant to assessment year 1998-99 and therefore that was the initial assessment year in which the assessee company was entitled to deduction under Section 80IA and the five years period expires on 2002-03. The assessee was, therefore, not entitled to deduction @ 100% of the profits of Goa unit and restricted the same to 30% of the profits from assessment year 2003-04.

6. The plea of the assessee was that trial production did not amount to manufacture of its products. It is only when commercial production commences, which according to the assessee commenced only in the assessment year 1999-2000, the assessee would become entitled to deduction under Section 80IA/80IB as per Clause(c) of Sub-section 12 of Section 80IA.

7. There is no dispute that first sale from Goa unit was made on 23rd April, 1998 which would be the period relevant to assessment year 1999-2000. The assessee had also produced evidence in the form of no objection certificate from local authority for manufacture operation in Goa unit as well as approval for release of HT power obtained by the assessee, which were granted only in the month of April, 1998. The assessee did not even have the requisite minimum number of employees employed in the previous year relevant to assessment year 1998-99. As against this, the plea of the Revenue is

that closing stock of finished goods of given unit as on 31st March, 1998 was shown by the assessee-company at Rs.1,49,405/- and there was no commercial production as claimed by the assessee, how the closing stock of finished goods could be valued at the aforesaid figure.

8. We are of the opinion that merely because some closing stock was shown as on 31st March, 1998, would not lead to the conclusion that there was commercial production as well. Naturally, even for the purpose of trial production material would be needed and there would be production which will result in stock of finished goods. Otherwise, there is overwhelming evidence produced by the assessee, and accepted by the Tribunal as well, from which it is clear that there was only a trial production in the assessment year 1998-99 and commercial and full-fledged production commenced only in the year 1999-2000. Therefore, we proceed further with the discussion on this basis.

9. The controversy, thus, boils down to the limited sphere namely whether, even with the start of trial production, with no commercial production in a particular year, it will be treated as "initial year" for the purpose of Section 80IA/80IB. The CIT(A) held so and this opinion of the CIT(A) did not found favour with the ITAT. The ITAT discussed the matter in the following manner:

> "The expression "initial assessment year" used in this context is defined in clause (c) of sub-section (12) of section 80-IA, according to which, "initial assessment year" in the case of an industrial undertaking means the assessment year relevant to the previous year in which the industrial undertaking begins to manufacture or produce articles or things. In the present case, the industrial undertaking of the assessee company at Goa had commenced the production on 20.3.1998 and although the same was a trial production, the stand of the Revenue is that there was still commencement of production in the previous year relevant to AY1998-99

> making the said year as "initial assessment year" within the meaning given in clause (c) of sub-section 80-IA. The stand of the assessee company, on the other hand, has been that the commercial production in Goa unit had commenced only in the previous year relevant to AY 1999-2000 after 1999-2000 was the initial assessment year for the purpose of claiming deduction u/s 80-IA/80-IB."

10. The Tribunal also took note of the judgment of Bombay High Court in ***Metropolitan Springs Pvt. Ltd.*** vs. ***Commissioner of Income Tax, (Central) Bombay***, ***132 ITR 893*** and that of Allahabad High Court in ***Commissioner of Income Tax*** vs. ***Himalyan Magnesite Ltd.***, ***276 ITR 56*** to support its view.

11. Challenging this decision of the Tribunal, present appeal is preferred and the question of law which arises is as under:

> "Whether the Ld. ITAT erred in allowing benefit of deduction u/s 801A/802B of the Act from the AY 98-99 (by treating the same as initial year of production) to AY 2003-04."

12. After hearing the counsel for the parties, we are of the opinion that the interpretation given by the Tribunal to Section 80IA/80IB is correct in law. Before the Bombay High Court, same question of law arose in ***Commissioner of Income Tax, Poona*** vs. ***Hindustan Antibiotics Ltd.***, ***93 ITR 548***. Provision which came for interpretation in that case was Section 15C of the Income Tax Act, 1922. However, language of the said provision and the purpose was the same. This Section 15C also provided tax exemptions to certain industrial undertakings who "has begun or begins to manufacture or produce articles……. ." The court was of the opinion that the provision must be interpreted having regard to the object for which the section was enacted namely to encourage the establishment of new industrial

undertakings by granting exemption from tax on profits derived from such undertakings during the first five years. The court in that case was also confronted with the situation where trial production had started during the particular assessment year but commercial production commenced only in the next assessment year. The court was of the opinion that merely trial production will not be regarded as beginning to manufacture or produce articles. Relevant portion discussing this aspect runs as under:

> “The question that arises for consideration in this case depends upon the correct interpretation of the expression "has begun or begins to manufacture or produce articles" used in section 15C(2)(ii). The first question that arises for consideration will be whether a were trial production will be regarded as beginning to manufacture or produce articles. On behalf of the revenue, the counsel has not contended to that extent, but his submission, however, is that before a finished product is produced by the assessee-company it is necessary to produce some other product at an earlier stage, mere production of that material at an earlier stage will be sufficient to come to the conclusion that the assessee-company had begun or begins to manufacture or produce articles. Reliance was placed by him upon two facts which are not disputed, namely, that the assessee-company commenced production or manufacture of crude penicillin on December 14, 1954, and that in the profit and loss account for the period ending March 31, 1955, there was a closing stock of crude penicillin worth Rs. 16,727. The argument was that sterile penicillin which is a final product saleable in the market can never be produced until first crude penicillin is produced or manufactured and if that be so, mere production or manufacture or crude penicillin will be regarded as beginning of manufacture or production of articles within the meaning of section 15C(2)(ii). The word "articles" used in this expression has to be interpreted regard being had to the object with which this section was enacted. Undoubtedly, the object was to encourage establishment of new industrial undertakings and such object was sought to be achieved by granting an exemption from tax to the extent of 6 per cent. per annum on the capital employed in the undertaking in the manner prescribed. If the object is to give exemption from tax, that presupposes that the real object is that the profits are capable of being earned by the company. If such be the object, then until the assessee-company reaches a stage where it is in a position to decide that a final product, which could ultimately be sold in the

> market, could be manufactured or produced by it, it will be idle formality to say that it had started manufacture or production of articles simply because trial products are prepared with a view to verify whether they can be ultimately used in the preparation or manufacture of the final products."

13. This judgment was followed by Bombay High Court in ***Metropolitan Springs Pvt. Ltd.(Supra)***, in the following manner:

> "In view of this decision, Mr. Mehta is right when he contends that the view of the Tribunal that once the materials are fed into the machine, whether for trial production or commercial production, it would amount to a manufacture for the purpose of the said sub-section, is incorrect, as being inconsistent with the view expressed by this court in the aforesaid decision. In the present case, however, we find that no material whatsoever has been produced by the assessee before any of the income-tax authorities, including the Tribunal, to show that the production made by the assessee in the calendar year 1951 was merely a trial production and that the goods produced were not for commercial sale but were merely for testing or sampling purposes, as in the case before the Division Bench of this court referred to above. As the Tribunal has pointed out, it was admitted by the assessee that it had commenced production in 1951, the contention of the assessee merely being that the said production was a trial production. As no material has been produced by the assessee at any stage to justify that contention, it must be taken as established that the assessee did not prove that the said production in 1951 was merely a trial production. The assessee must, therefore, be held to have commenced production in 1951 and was not entitled to the benefit of the exemption under s. 15C of the said Act in respect of newly established industrial undertakings, beyond the assessment year 1956-57."

14. The Allahabad High Court took the same view in ***Himalyan Magnesite Ltd.(Supra)*** accepting the ratio in ***Hindustan Antibiotics Ltd.(Supra)***. That case concerns with Section 80J of the Income Tax Act, 1961 and is in *pari materia* with Section 80IA/80IB. The only difference is that under Section 80J similar benefit is available to newly established industrial undertakings, ships or hotel business in certain circumstances.

15. The Madras High Court in the case of ***Additional Commissioner of Income Tax, Madras-II*** vs. ***Southern Structurals Ltd.***, ***164 ITR 110***, have also hold the line following ***Hindustan Antibiotics Ltd.(Supra)***.

16. In view of consistent view taken by various High Courts, we do not find any reason to take a different view and are in respectful agreement with the dicta laid down in the aforesaid judgments. It is more so when even this Court, way back in the year 1984, in ***Commissioner of Income Tax*** vs. ***Food Specialities Ltd., 156 ITR 790***, followed the ratio of ***Hindustan Antibiotics Ltd.(Supra)*** as is clear from the following:

> "As regards the year of manufacture, on the question whether there can be an experimental period, a reference was made to the case of *CIT* v. *Hindustan Antibiotics Limited, 93 ITR 548* and *Madras Machine Tools Manufacturers Ltd.* v. *CIT,* 98 ITR 119 in both of which it was held that manufacturing for the purpose of section 15C of the 1922 Act and section 84 of the 1961 Act was the date of "commercial" manufacture and the period during which experimental work, particularly manufacture, was effected had to be disregarded.
>
> It, therefore, appears that there is an authoritative view that section 84 commences to operate not from the date when an undertaking physically starts to manufacture but operates from the date on which commercial manufacture is to start. This observation was made in the light of section 84(7) which states that the provisions of the section in relation to an industrial undertaking is to apply is from the assessment year relevant to the previous year in which the undertaking begins to manufacturer produce articles. It so happened that on experimental basis, the assessee, in the present case, started manufacture in December, 1963, but on commercial basis, this started only in January, 1964, which would be in the assessment year 1965-66. The controversy that seems to have arisen was whether the experimental portion of manufacture was to be considered as a period during which "manufacture" had taken place for the purpose of applying section 84(7)."

17. We may note here that learned counsel for the Revenue had made a fervent plea before us to discard the aforesaid interpretation in view of the Supreme Court judgment in ***Commissioner of Income Tax*** vs. ***Sesa Goa Ltd.***, ***271 ITR 331***. In that case the question was as to whether extraction and processing of ore amounts to production or not within the meaning of Section 32A of the Income Tax Act. The court was thus called upon to decide as to what is the meaning of production. It was in all together in different context. On the other hand question before us is not as to whether a particular activity amounts to manufacture or not but issue is what would be the initial year of production for the purpose of Section 80I.

18. We, thus, answer the question against the Revenue and in favour of the assessee and as consequence dismiss these appeals.

ITA No. 160/2008, ITA No. 161/2008 & ITA No. 793/2009

19. Question involved in all these three appeals is same which we have discussed earlier. It also arises under Section 80IA of the Act. The Tribunal has even taken note of judgment of Bombay High Court, Allahabad High Court as well as Madras High Court, holding that there should be regular production and not the trial production. However, on facts the Tribunal decided the case against the assessee. What weighed with the Tribunal was that the assessee had not only produced the goods for trial purposes but there was, in fact, sale of one water cooler and air-conditioner in the assessment year 1998-99 relevant to the previous year/financial year 1997-98. The explanation of the assessee that this was done to file the registration under the Excise Act as well as the Sales Tax Act. This did not find favour with

the ITAT. Analyzing the judgment of ***Himalyan Magnesite Ltd.(Supra)*** in the context of the case at hand the Tribunal concluded as under:

> "Coming to the ratio of the case of Himalayan Magnesite Ltd. (supra), the court distinguished between trial production and production of goods or articles. Generally, trial production is undertaken with a view to test whether the final goods are of marketable quality or not. If the goods are found to be sub-standard, the process of production may have to be checked and improved so that marketable goods start getting produced or manufactured. However, once final goods, for which the unit was set up, were produced and sold, then there remains no scope for saying that it was merely a trial production and not production of articles or things. We are fortified in this view by the failure of the assessee to show that there was any defect in the water cooler and air-conditioner produced and sold by the assessee and that they were returned to it by the dealer. The assessee has also not led evidence to show that no production could be carried out in April, 1998, because of any defect in the process of manufacture, as the section does not speak of sales but of production or manufacture. Therefore, we are of the view that commercially saleable water cooler and air-conditioner were started to be manufactured in financial year 1997-98. Coming to section 80-IA(2), it contains two types of conditions, (i) which have to be satisfied at the outset for the very eligibility of grant of deduction u/s 80-IA for all times, and (ii) which have to be examined from year to year. It may happen that the unit is otherwise eligible for deduction as once for all conditions have been satisfied and subsequently or even in the very first year some other criteria of number of employees etc. is not satisfied. This would mean that the unit is eligible for deduction u/s 80-IA, but the exemption for that year cannot be granted. Therefore, the argument of the ld. Counsel, based upon aforesaid provision, has no bearing on the issue of the determination of the initial year of "manufacture of articles or things". Thus, we are of the view that assessment year 1998-99 was the initial year as defined in section 80-IA(12) and consequently, this year is the third year of exemption u/s 80-IA."

20. Thus, the distinguishing feature is that after the production, commercial sale also took place as well before on 31st March, 1998. In this factual scenario following question of law was framed in these appeals:

> "Whether the ITAT was correct in law and on facts to hold that sale of one water cooler and one air-conditioner as on 31.03.1998 for the purposes of obtaining registration of excise ad sales tax was 'manufacturing' within the meaning of Section 80IA?"

21. When we carefully examine the ratio laid down in various judgments noted above while dealing with ITA No. 1154/2009, we arrive at irresistible conclusion that the decision rendered by the Tribunal is without blemish and does not call for any interference. The provisions of Income Tax Act use the word "manufacture". Trial production is not regarded as beginning to manufacture or to produce articles because of the reason that the assessee has to produce trial production to verify whether it can be used ultimately in the manufacture of the final article. These are, therefore, "trial runs". The article is tested to find out as to whether it can be launched as a final product in the market or not. Therefore, with mere trial production, the manufacture for the purpose of marketing the goods has not started which starts only with commercial production namely when final product to the satisfaction of the manufacturer has been brought into existence and is now fit for marketing.

22. In ***Hindustan Antibiotics Ltd.(Supra)***, the court found that sterile penicillin which was a final product, saleable in the market, can never be produced until first crude penicillin is produced or manufactured and if that be so, mere production or manufacture of crude penicillin will not be regarded as beginning of manufacture or production of articles. The court opined that until the assessee-company reaches a stage where it is in a position to decide that a final product, which could ultimately be sold in the market, could be

manufactured or produced by it, it will be idle formality to say that it had started manufacture or production of articles, simply because trial products are prepared with a view to verify whether they can be ultimately used in the preparation or manufacture of the final products.

23. In the present case, the assessee had sold one water cooler and one air-conditioner before April, 1998. Thus, the stage of trial production had been crossed over and the assessee had come out with the final saleable product which was in fact sold as well. The quantum of commercial sale would be immaterial. With sale of those articles marketable quality was established, more particularly when assessee failed to show that the dealer returned those goods on the ground that there was any defect in the water cooler or air-conditioner produced and sold by the assessee to the dealer. Things would have been different if that had happened. The Tribunal, in the circumstances, is right that the two types of conditions stipulated in Section 80IA were fulfilled with the commercial sale of the two items in that assessment year. Whether the purpose of that sale was to obtain registration of excise or sales tax would be immaterial.

24. We thus answer the question as framed against the assessee and in favour of the Revenue and dismiss these appeals.

A.K. SIKRI, J.

SIDDHARTH MRIDUL, J.

DECEMBER 23, 2009
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