THE HIGH COURT OF DELHI AT NEW DELHI

% Judgment delivered on: 28.01.2010

\+ **ITA 547/2009**

COMMISSIONER OF INCOME TAX ... Appellant

- versus –

ACC RIO TINTO EXPLORATION LTD ... Respondent

Advocates who appeared in this case:-
For the Petitioner : Ms P. L. Bansal
For the Respondent : Mr Salil Kapoor with Ms Swati Gupta and Mr Ankit Gupta

CORAM:
HON'BLE MR JUSTICE BADAR DURREZ AHMED
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 Digest?

BADAR DURREZ AHMED, J (ORAL)

1. This appeal has been filed by the revenue against the order of the Income Tax Appellate Tribunal dated 26.09.2008 passed in ITA No. 4908/Del/2005 relating to the assessment year 2001-2002.

2. As would be apparent from the very first paragraph of the impugned order, the only ground taken by the revenue in this appeal before the Tribunal was that the Commissioner of Income Tax (Appeals) had erred in deleting the addition of Rs 1,61,80,156/- made by the Assessing Officer inasmuch as according to the revenue the Commissioner of Income Tax

the Act which, according to the revenue, were clearly applicable. Thus, the entire controversy before us is limited to the question of applicability of Section 35E of the Income Tax Act, 1961 (hereinafter referred to as 'the said Act').

3. The facts are that the assessee, which is a company engaged in the business of prospecting and exploring ores and minerals, had filed a return declaring a loss of Rs 3,00,52,260/-. In the year in question, the assessee had changed the accounting policy in respect of the expenditure incurred on such activities. Earlier, the expenditure was being capitalized as work in progress but in this year the same was charged to the Profit & Loss Account. It was made clear by the assessee before the Assessing Officer itself that the assessee was engaged in the business of exploring and prospecting of ores and minerals and that it was not engaged in the commercial production of any mineral. The assessee had explained before the Assessing Officer that it had decided to change the accounting policy to bring it in line with the worldwide policy of the parent group, namely, Rio Tinto group. As per the assessee, the changed policy furnished the true and fair representation of the profits of the assessee company and that the change was permitted as per the Accounting Standards I and II.

4. However, the Assessing Officer did not agree with the submissions made by the assessee and, inter alia, observed as under:-

"(iv) The apparent reason for change in accounting policy seems

commercial production is started to be claimed in the year of the commercial production and so on. Since, the company has already completed four years, it has changed its accounting policy so that the provision of Section 35E is circumvented and the losses are claimed as business losses which are allowed to be carried forward for 8 years. Therefore, the change in accounting policy is a colourable device to understate the income tax liability of the assessee company because if the accounting policy is not changed, the expenses incurred more than 4 years prior to year of commercial production will be a dead loss for the company.

(v) Regarding the revenue source of the company, the assessee has replied that it can generate revenue on two counts, namely, sale/disposal of data collected and preferential right for mining. It is thus very clear that at this stage the company has not reached at a stage where any revenue can be generated, it is in a stage of exploration only where it is looking for the mines in which the actual mining operation will be carried out by the company. Therefore, the business of the assessee has not commenced."

5. The Commissioner of Income Tax (Appeals), in the appeal preferred by the assessee, while deleting the addition made by the Assessing Officer, came to the conclusion that the activity of exploration constituted a separate activity by itself as different and distinct from commercial production. The Commissioner of Income Tax (Appeals) also noted that the assessee had received permission from the Foreign Investment Promotion Board (FIPB) only with respect to exploration activity in various States in India. There was no permission with regard to any mining activity. It was also noted that in case the assessee wanted to commence any mining activity, a separate permission would have to be obtained from the FIPB.

6. As we have mentioned above, the only ground taken by the revenue was that the Commissioner of Income Tax (Appeals) had come to the

Section 35E of the said Act. The Tribunal went into this question and in so doing had noticed the main objects of the assessee company, which were as follows:-

> "1. To carry on in India all or any of the businesses of prospecting, exploring, research, finding all sorts of present and future ores, minerals, deposits, goods, substances and materials including but not limited to gold, silver, diamonds, precious stones, and other stones, aluminum, titanium, iron ore, coal, mica, apalite, chrome, copper, gypsum, lead manganese, molybdenum, nickel, platinum, uranium, rutile, sulphur, tin, zinc, zircon, bauxite, tungsten, sands, stones, soils, chalk, clay, china-clay, bentonite, boryles, calcite, lignite, rockphosphate, brimstone, brine vanadium, sulphate and other base and precious materials and to hold prospecting licenses and any other licenses required for the above mentioned activities and to sell or otherwise transfer any of these licenses and all related data, information and technology and physical assets.
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> 2. To act as consultants/ advisors, experts and technical collaborators to render technical and consultancy services in all area of prospecting, exploring finding and research and other related activities.
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> 3. To design manufacture supply, buy, sell, import, export and deal in plant and machinery, tools and equipments related to prospecting exploring, finding and research and other related activities.
>
> 4. To supply trained manpower, trained personnel to make evaluations, feasibility studies, techno-economic feasibility studies, project reports, forecasts and surveys."

Thereafter, the Tribunal also noticed the permission letter dated 29.10.1996 issued by the Department of Industrial Policy and Promotion, whereby the approval was granted to the assessee company for carrying on its prospecting activities. Paragraph 5 of the said letter reads as under:-

> "5. The approval is subject to the condition that the joint venture company shall apply afresh for obtaining a prospective

given only for prospecting and for actual mining the company will have to seek further approval of FIPB/ Government.

7. Going through the objects of the assessee company and the permission granted by the FIPB, the Tribunal, in our view rightly so, came to the conclusion that the assessee was not in the business of mining ores or mineral and that it was only in the business of prospecting or exploring the ores and minerals. Consequently, the argument of the Assessing Officer, that the assessee had not commenced its business, was held to be incorrect. We agree with this conclusion, which is based purely on the facts of the present case.

8. With regard to the applicability of the provisions of Section 35E, the Tribunal came to the conclusion that unless and until there is commercial production, the said provisions would not apply. Section 35 E(1) and (2) read as under:-

> "**35E.** (1) Where an assessee, being an Indian company or a person (other than a company) who is resident in India, is engaged in any operations relating to prospecting for, or extraction or production of, any mineral and incurs, after the 31st day of March, 1970, any expenditure specified in sub-section (2), the assessee shall, in accordance with and subject to the provisions of this section, be allowed for each one of the relevant previous years a deduction of an amount equal to one-tenth of the amount of such expenditure.
>
> (2) The expenditure referred to in sub-section (1) is that incurred by the assessee after the date specified in that sub-section at any time during the year of commercial production and any one or more of the four years immediately preceding that year, wholly and exclusively on any operations relating to prospecting for any mineral or group of associated minerals specified in Part A or Part B, respectively, of the Seventh

> **Provided** that there shall be excluded from such expenditure any portion thereof which is met directly or indirectly by any other person or authority and any sale, salvage, compensation or insurance moneys realised by the assessee in respect of any property or rights brought into existence as a result of the expenditure."

It would also be relevant to refer to Section 35 E (5), which reads as under:-

> "(5) For the purposes of this section,—
>
> (*a*) "operation relating to prospecting" means any operation undertaken for the purposes of exploring, locating or proving deposits of any mineral, and includes any such operation which proves to be infructuous or abortive;
>
> (*b*) "year of commercial production" means the previous year in which as a result of any operation relating to prospecting, commercial production of any mineral or any one or more of the minerals in a group of associated minerals specified in Part A or Part B, respectively, of the Seventh Schedule, commences;
>
> (*c*) "relevant previous years" means the ten previous years beginning with the year of commercial production."

Upon a plain reading of the said provisions of Section 35E, it is apparent that unless and until there is commercial production, the provisions of Section 35E (1) would be unworkable. The expression "year of commercial production" referred to in Section 35E (2) is defined in Section 35E(5) (b) to mean the previous year in which as a result of any operation relating to prospecting, commercial production of any mineral or any or more of the minerals…….commences. Thus, unless and until there is actual commercial production, the phrase "year of commercial production", appearing in Section 35 E (2), would be rendered meaningless.

9. In the present case, the Tribunal has, on facts, come to the conclusion that the assessee company's objects did not include mining of ores or minerals or commercial production, in the sense understood within the meaning of Section 35 E of the said Act. Consequently, the Tribunal agreed with the assessee's contention that there would never be commercial production of any mineral or ore as a part of the activities of the assessee in view of the very objects of the assessee company and the FIPB permission given to the assessee company. Consequently, the provisions of Section 35 E would not be applicable to the facts and circumstances of the present case as there was no possibility of any commercial production. We agree with this reasoning.

10. Consequently, we find that no substantial question of law arises for our consideration. The appeal is dismissed.

BADAR DURREZ AHMED, J

SIDDHARTH MRIDUL, J

JANUARY 28, 2010
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