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

\+ **ITA No. 551/2013 and 553/2013**

Reserved on: 15th December, 2014

% **Date of Decision: 5th February, 2015**

Commissioner of Income Tax – I ....Appellant

Through Mr. N.P.Sahni, Sr. Standing Counsel with Mr. Nitin Gulati, Jr. Standing counsel and Mr. Juoy James, Advocate.

Versus

M/s AAR ESS EXIM PVT. LTD. …Respondent

Through Mr. Rakesh Gupta with Mr. Rishabh Kapoor, Advocates.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE V. KAMESWAR RAO

SANJIV KHANNA, J.

These two appeals by the Revenue relating to assessment years 2007-08 and 2008-09 require adjudication on the following substantial question of law:

> "Whether the respondent assessee is entitled to benefit under Section 10B of the Income Tax Act, 1961 as he was engaged in manufacture or production of an article or thing?

2. These appeals arise from a common order of the Income Tax Appellate Tribunal (Tribunal, for short) dated 18th April, 2013.

3. The respondent assessee is a company engaged in the business of manufacture, trading and export of engineering goods etc. and also has a factory located in Noida Export Processing Zone, Uttar Pradesh. The said unit is a 100% export oriented and located in customs bounded area.

4. For the assessment year 2007-08, the respondent assessee h filed return declaring loss of Rs.4,11,190/- and had claimed deduction/exemption under Section 10B of the Income Tax Act, 1961 (Act, for short) on profit of Rs.69,69,429/- from the Noida Unit. The Assessing Officer did not allow deduction under Section 10B on the ground that the assessee had not manufactured any goods in the Noida Unit. He referred to reply received from R.N. Metals, Jaipur, M/s Sustul Engg. Corp. Mumbai, M/s Chanderpur Works Yamuna Nagar (Haryana) to the effect that they had manufactured and exported various goods on behalf of respondent assessee. He observed that the aforesaid letters showed that the assessee itself had not undertaken manufacturing activities. The assessing officer noticed that the asessee had incurred electricity expenditure of Rs.19,771/- during the year and Rs.2,27,694/- in the previous year, through they had turnover of Rs.18.92 lacs and had shown opening stock of work in progress of Rs.1.6 crores. The total turnover from Noida unit as declared was Rs.6,19,35,990/-.

5. For the assessment year 2008-09, the assessment order is more detailed and elaborate. The assessee had filed return declaring NIL income and had claimed exemption/deduction under Section 10B of Rs.12,17,41,816/-. The assessee had claimed that they had earned exempt income as they had carried out upgradation of cement plant in Zambia and also received consideration for design, fabrication and commissioning of a steel rolling mill in Kazakhastan. The assessee had filed a flow chart to explain the nature of work undertaken to support their claim under Section 10B of the Act. It was asserted that the respondent was a multifaceted project engineering company

having highly qualified engineers, technocrats etc., who had extensi experience, and expertise in executing turnkey projects of diverse nature. The Assessing Officer, however, held that the assessee was not carrying on manufacturing and assembling activities as they had erected the steel rolling mill and the cement plant abroad. The assessee himself did not manufacture any goods but had removed various parts after testing and disassemble them for the purpose of export. Testing, painting or prepackaging for export cannot be construed as manufacture or assembling activity. The assessee himself did not possess adequate plant, machinery or infrastructure to carry out manufacturing activities. Written down value of plant and machinery in the Noida unit was only Rs.1,81,153/-. The assessee had also purchased plant and machinery worth Rs.6,45,659/- during the year, out of which Rs.1,43,950/- were paid for air conditioners and EPABX. On site inspection at Noida, it was noticed that the assessee had installed lathe machines, welding sets, cutting machine, weighing machine, cranes, electric hoists and chain pully. The said plant and machinery were for loading, unloading of materials received, upkeep, painting etc. for exports. The assessee had incurred electricity expenses of Rs.29,184/- on export turnover of Rs.26,00,63,634/-. The assessee had not debited any generator expenses. The salaries paid to the workers were not proportionate to the export turnover. The inference drawn was that the assessee was not engaged in manufacturing activity. The Assessing Officer disallowed the claim for deduction/exemption of Rs.12,17,41,860/- under Section 10B, as made in the return. He also made additions in alternative. Total

income of the assessee on the basis of aforesaid addition and oth additions was computed at Rs.10,86,14,708/-.

6. The assessee succeeded in the first appeals as Commissioner of Income Tax (Appeals) decided the issue in favour of the assessee. The Commissioner (Appeals) in addition to giving finding on merits in favour of the respondent assessee, applied the principle of consistency. As is apparent, the aforesaid findings have been a affirmed in favour of the respondent assessee by the Tribunal.

7. In order to decide, the controversy, we would like to reproduce Section 10B(1), (2), (4) and Explanation 2 clauses (iii) and (iv) and Explanation 4 to Section 10B which read:

> **"10B.** (1) Subject to the provisions of this section, a deduction of such profits and gains as are derived by a hundred per cent export-oriented undertaking from the export of articles or things or computer software for a period of ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or things or computer software, as the case may be, shall be allowed from the total income of the assessee :
>
> **Provided** that where in computing the total income of the undertaking for any assessment year, its profits and gains had not been included by application of the provisions of this section as it stood immediately before its substitution by the Finance Act, 2000, the undertaking shall be entitled to the deduction referred to in this sub-section only for the unexpired period of aforesaid ten consecutive assessment years :
>
> [**Provided** [**further**] that for the assessment year beginning on the 1st day of April, 2003, the deduction under this sub-section shall be ninety per cent of the profits and gains derived by an undertaking from the export of such articles or things or computer software:]
>
> **Provided also** that no deduction under this section shall be allowed to any undertaking for the assessment year beginning on the 1st day of April, [2012] and subsequent years :

[**Provided also** that no deduction under this section shall be allowed to an assessee who does not furnish a return of his income on or before the due date specified under sub-section (1) of section 139.]

(2) This section applies to any undertaking which fulfils all the following conditions, namely :—

(*i*) it manufactures or produces any articles or things or computer software;

(*ii*) it is not formed by the splitting up, or the reconstruction, of a business already in existence :

Provided that this condition shall not apply in respect of any undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section ;

(*iii*) it is not formed by the transfer to a new business of machinery or plant previously used for any purpose.

Explanation.—The provisions of *Explanation 1* and *Explanation 2* to subsection (2) of section 80-I shall apply for the purposes of clause (*iii*) of this sub-section as they apply for the purposes of clause (*ii*) of that sub-section.

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[(4) For the purposes of sub-section (1), the profits derived from export of articles or things or computer software shall be the amount which bears to the profits of the business of the undertaking, the same proportion as the export turnover in respect of such articles or things or computer software bears to the total turnover of the business carried on by the undertaking.]

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Explanation 2.—For the purposes of this section,—

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(*iii*) "export turnover" means the consideration in respect of export [by the undertaking] of articles or things or computer software received in, or brought into, India by the assessee in convertible foreign exchange in accordance with sub-section (3), but does not include freight, telecommunication charges or insurance attributable to the delivery of the articles or things or computer software outside India or expenses, if any, incurred in foreign exchange in providing the technical services outside India;

(*iv*) "hundred per cent export-oriented undertaking" means an undertaking which has been approved as a hundred per cent export-oriented undertaking by the Board appointed in this behalf by the Central Government in exercise of the powers conferred by section 14 of the Industries (Development and Regulation) Act, 1951 (65 of 1951), and the rules made under that Act;

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[Explanation 4.—For the purposes of this section, "manufacture or produce" shall include the cutting and polishing of precious and semi-precious stones.]"

8. Sub-section (1) to Section 10B states that a deduction of such profits and gains as derived from 100% export oriented undertaking from export of articles, things or computer software would be allowed for 10 consecutive assessment years beginning from the year in which the undertaking begins to manufacture or produce articles, things or computer software. Thus for deduction/exemption to be allowed under Section 10B of the Act, the undertaking in question should be 100% export oriented. The profits derived by the said undertaking from export of articles, things or computer software is treated as exempt/deductible for 10 consecutive years beginning from the year when manufacture/production starts. The provisos curtail the quantum of deduction and stipulate how the same is to be computed.

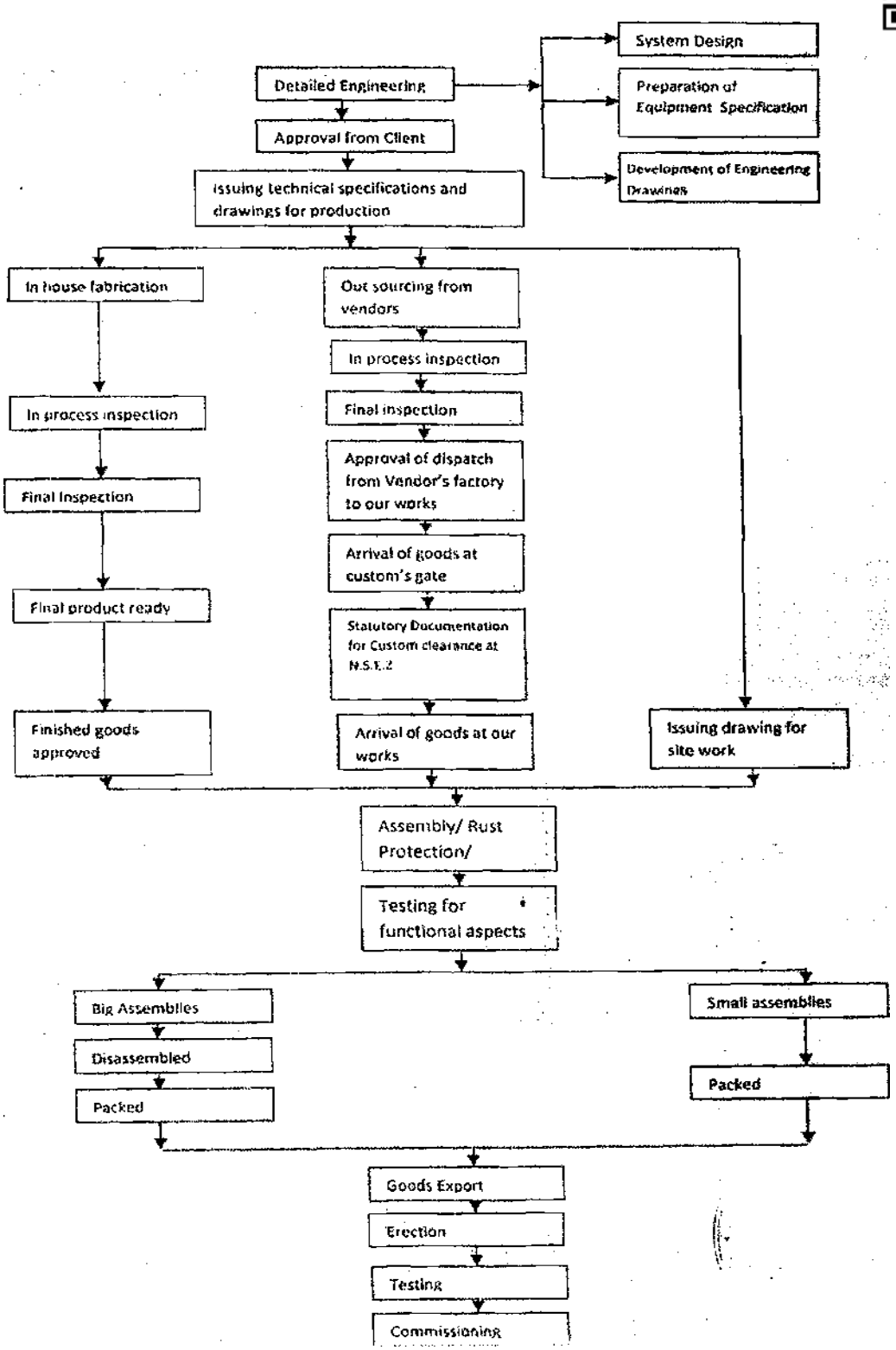
9. Sub-section (2) stipulates that Section 10B would only apply to an undertaking which manufactures or produces, articles or things or computer software. Such undertaking should not be formed by splitting, reconstruction of existing business and not formed by transfer to new business, machinery or plant previously used. Explanation 2 – clause (iv) states that 100% export oriented undertaking means an undertaking approved as 100% export oriented

undertaking by the Board appointed in this behalf by the Centr Government in exercise of powers under Section 14 of Industries (Development and Regulation) Act, 1951. Sub-section (3) states that sale proceeds of articles and things or computer software exported outside India should be received in India in convertible form within the time limit so stipulated. Sub-section (4) prescribes the method to compute profits derived from export of articles and things, which shall be the proportionate amount which bears to the profit of the business of the undertaking, as turnover of such article or thing or computer software bears to the total turnover of business. The term 'export turnover' has been defined for the purposes of said section in clause (iii) to explanation 2 and means consideration received in convertible foreign exchange in respect of exports by the undertaking, of articles or things of computer software, received or brought into India. It does not include freight, telecommunication charges or insurance attributable to delivery or expenses, if any, incurred in foreign exchange for providing technical services outside India. In Explanation 3, for removal of doubts, it has been declared that profits and gains derived from on site development of computer software, services for development of software outside India shall be deemed to be profits and gains derived from computer software exported outside India. Thus, on site development of computer software including services for development of software outside India would be treated as profits and gains derived from export of computer software. The aforesaid explanation begins with the expression 'for removal of doubts'. Use of this expression is significant and important. The said explanation was added by Finance Act, 2001 w.e.f. 1st April, 2001. In

Explanation 4, the expression 'manufacture or produce', it has be elucidated, would include cutting and polishing of precious or semi precious stones.

10. A reading of the aforesaid clauses would indicate that Section 10B of the Act is beneficial provision and has been enacted to give tax concession or exemption to 100% export oriented units engaged in manufacture or production of articles, things or computer software. The exemption is only granted if the assessee has been declared as an 100% export oriented undertaking which means an undertaking approved by the Board appointed in this behalf under the Industries (Development and Regulation) Act, 1951. It is an undisputed and a factual position recorded by the Tribunal that the respondent assessee had an export oriented unit in Noida Export Processing Zone, which was duly approved. The Tribunal has also recorded that the Development Commissioner, Noida Export Process Zone, had extended all facilities and privileges admissible to the said unit under the Export-Import Policy 1997-2002. One of the conditions, for establishment of an undertaking in the said zone was that the undertaking should be manufacturing engineering products and the entire production should be exported, after excluding the rejects and permissible sales in the domestic tariff area. The respondent has entered into an agreement with the said authority for carrying on the said business.

11. The impugned order passed by the Tribunal has referred to and accepted the flow chart filed by the respondent assessee before the Assessing Officer and the same for the sake of convenience is reproduced below:-



A reading of the aforesaid flow chart would disclose that the respondent assessee had carried out detailed engineering analysis of system design, equipment specifications and development and

preparation of engineering drawings. Thereafter approval was tak from the client. At the next stage, the assesseed issued technical specification and drawings for production, which activity was outsourced to vendors. During the course of production by the third parties vendors, process inspection and final inspection was undertaken. After approval, the goods were dispatched from the vendors' factory to the assesseed. The goods were then examined at the Noida Unit and approved. The respondent-assessee had also undertaken in-house fabrication in addition to inspection at the vendors factory to whom the production or manufacture had been outsourced. Once the goods were received at the Noida unit, they were examined and assembled and tested. Rust protection was undertaken. Big assemblies were disassembled and repacked. Small assemblies were packed as such. Thereupon, the goods were exported from India and erected at the site, tested and then commissioned. The Tribunal has referred to the following activities specifically undertaken by the assessee and the relevant portion reads:-

S.No.	**Description of Component**	**Manufacturing Process performed by the Appellant**
1.	AC Frequency Drive	The AC Frequency drive was purchased as per Assessee's design specifications & integrated with a squirrel cage motor by programming its Programmed Logic Controller (PLC) to required operational parameters and mounting it on motor control panel; after the above said processing the manufactured item is called MOTOR SPEED CONTROLLER, and was sold as such vide our Invoice dated 19/08/2006. The other AC frequency Drives were similarly processed and fixed to Screw

		Conveyor for its step-less spe control.
2.	(a) Aeration Boxes. (b) Aeration Cloth. (c) Air Lift Assembly. (d) Air Lift with Expander. (e) Air Slides (f) Rotary Vane Feeder	The equipment mentioned in the Column "A" of this table were purchased by assessee as per its technical specifications and drawings and after inspection they were assembled into subassemblies & assemblies to manufacture Pneumatic material conveyors and Kiln feeding mechanism. The equipment are assembled together to ensure exact mating of the parts and tested for efficiency by injecting compressed air. The large sections are then disassembled into subassemblies, packed and containerized for shipment. For details lease refer to **Appendix 1.**
3.	(a) Instruments. (b) Kiln hood. (c) Nodulizer feed hopper & overflow screw conveyor. (d) Pneumatic Cylinder. (e) Refractory bricks & Powder (f) Repair kit for cylinder (g) Screw Conveyor (h) Settling Chamber (i) VSK Gearbox and accessories. (j) VSK Shell and Chimney (k) Nodulizer	The equipment mentioned in the Column "A" of this table were purchased by assessee as per its technical specifications and drawings and after inspection they were assembled into subassemblies & assemblies to manufacture Vertical Shaft Kiln. The large sections are then disassembled into subassemblies, packed and containerized for shipment. For details please refer to **Appendix 2**.
4.	(a) Forged hyper-steel (b) Hot air furnace. (c) Liners. (d) Liner bolts for cement mill. (e) Liner bolts for Raw Mill. (f) Raw mill accessories (g) Raw Mill Parts (h) Grit separator.	The equipment mentioned in the Column "A" of this table were purchased by assessee as per its technical specifications and drawings and after inspection they were assembled into subassemblies & assemblies to manufacture Raw Mill & Cement Mill. The Liners are fitted on the inner

		surface of the Mill Shell using the nuts and bolts before fixing the end covers; they prevent wear of the mill shell. The large sections are then disassembled into subassemblies, packed and containerized for shipment. For details please refer to the **Appendix 3.**
5.	Cyclone.	The equipment mentioned in the Column "A" of this table was purchased by assessee as per its technical specifications and drawings and after inspection it was assembled with a Hammer Mill using support and frame; it works to reduce pollution by trapping dust generated by the Hammer Mill. After testing it is disassembled from the Hammer Mill and dispatched as Cyclone Separator with support and embedded frame. For details please refer to the **Appendix 4**
6.	(a) Bucket Elevator Parts (b) Chain for the Bucket Elevator	The equipment mentioned in the Column "A" of this table were purchased by assessee as per its technical specifications and drawings and after inspection they were assembled together to make a bucket elevator, the elevator was tested for Conformance with the design parameters and thereafter disassembled to shippable size for shipment. For details please refer to **Appendix 5**
7.	(a) Bags of Dust Collector. (b) Sequential Timer (c) Solenoid Valve	The equipment mentioned in the Column "A" of this table were purchased by assessee as per its technical specifications and drawings and after inspection they were assembled together to make Oust Collector, the Oust Collector was

		tested for conformance with the desi Parameters and thereafter disassembled for safe shipment as they are delicate items. For details please refer to **Appendix 6**
8.	(a) Table Feeder. (b) Table Feeder	The equipment mentioned in the Column "A" of this table were purchased by assessee as per its technical specifications and drawings and after inspection they were assembled together to make a Material by assembling with it scrapper, drive shaft, gearbox, motor etc and fixing the assembly to the Hopper; after, testing the system is disassembled into subassembly called Table type material proportionator. For details refer to **Appendix 7**.
9.	Grit Separate	The equipment mentioned in the Column "A" of this table were purchased by assessee as per its technical specifications and drawings and after inspection they was assembled together to make a Coarse Particle Cyclone which is fitted in the Raw Mill section to perform its duty of recycling under done material to the Raw Mill. For details please refer to **Appendix** 3
10.	Slide Gate.	The equipment mentioned in the Column "A" of this table was purchased by assessee as per its technical specifications and drawings and after inspection it was fixed to a hopper to make a. Material Charging Door. For details please refer to **Appendix 8**
11.	(a) Macc 125A Current Collectors. (b) Safetrack2, SF 2- 200A aluminum shrouded conductor system (c) M.S. Fabricated supports	The equipment mentioned in the Column "A" of this table were purchased by assessee as per its technical specifications and drawings and after inspection they was assembled together to make a Down Shop Lead for the Electrically Operated Travelling Crane (EOT). After testing for current carrying capacity and other factors they

		were disassembled and prope packed as there are number of small components which may get misplaced during transit. It is then installed on the EOT at the Plant site. For details please refer to the **Appendix 9.**

12. In respect of assessment year 2007-08, no division of cost of the exported goods and the erection or commissioning costs are available. This aspect was not elucidated and mentioned. In respect of assessment year 2008-09, the assessment order refers to the fact that the assessee had erected cement/steel rolling mills abroad and therefore assessee was not engaged in export, manufacture or production of goods and things, but again the Assessing officer did not bifurcate the said figures into service element and export value of goods etc. No such attempt of bifurcation was made before the Tribunal or before us.

13. We have referred to Explanation 2 clause (iii) which defines the term 'export turnover' to mean consideration in respect of export by the undertaking of articles or things and excludes freight, telecommunication, insurance charges attributable to delivery of articles and lastly expenses incurred in foreign exchange in providing technical services outside India. Thus, expenses for providing technical services incurred outside India in foreign exchange are to be excluded from export turnover. In other words, expenses incurred in providing technical services outside India but not incurred in foreign exchange, form part of the turnover and are not to be excluded. This is inspite of the fact that under sub-section (1) and (2) there is direct reference to profits and gains derived from export of articles or things

or computer software by 100% export oriented unit. The profits a to be computed with respect to export turnover under sub-section (4) in respect of such articles, things or computer software in proportion to the total turnover of the business carried on by the undertaking. Thus, while computing export turnover in terms of clause (iii) to Explanation 2, expenses incurred for providing technical services outside India in connection with articles or things so exported would be included and added, provided the said expenditure was not incurred in foreign exchange. The Legislature was conscious that an assessee engaged in export of articles or things may have to incur expenditure in nature of technical services in connection with the said exports and in a given case would be reimbursed or paid for the said expenditure. The payment received for the aforesaid expenditure would be included in the export turnover, provided the expenditure was not incurred in foreign exchange. The explanation only excludes expenses incurred in foreign exchange in providing technical services outside India. The services must be provided by the assessee, i.e. in respect of services provided by the assessee outside India. Explanation 3 which uses the expression 'for removal of doubts' in the case of computer software states that on site development including services for development of software outside India shall be deemed to be profits and gains derived from export of computer software outside India. The use of expression 'for removal of doubts' has to be contrasted from the term 'deemed' used in the same explanation but we feel that the said expression shows the underlying objective and purpose behind the provision i.e. Section 10B of the

Act. Software developed outside India or even services f development of software outside India is to be and regarded as export.

14. Read in this manner, we feel that the fact that the respondent assessee had assembled the entire plant outside India from the goods supplied and manufactured in India would include the expenditure incurred for commissioning and providing technical services outside India, after excluding expenses in form of payment made in foreign exchange for technical services provided outside India. It is not the case of the Revenue that the respondent assessee had made payment in foreign exchange for technical services provided outside India.

15. The next question which arises for consideration is whether the assessee can be considered to be engaged in manufacture and production of articles or things. We have already recorded the findings of the Tribunal on the said aspect. It is apparent that the respondent assessee did not self-manufacture or produce most of the articles or things which were exported and used for setting up the plant. The assessee had undertaken detailed engineering drawings and as per the specification and drawings, the actual manufacture and production work was outsourced. Throughout the said process, inspection was carried out and only after approval, the goods were dispatched. The goods were re-inspected, checked, assembled and disassembled, before they were exported out of India. Only upon satisfactory performance and ensuring that there was perfect matching, the goods were exported. We are in agreement with the findings recorded by the Tribunal that the aforesaid activities qualify and should be treated as manufacture or production of goods by the assessee himself. On the said aspect we would like to reproduce our

finding in ***ITA 141/2002, Commissioner of Income Tax Vs. Hari India Limited, Dated 22.12.2014,***which read :-

> 10. The next aspect or the question is whether the assessee was engaged in manufacture or processing of jewellery or was merely procuring jewellery from the market as a trader and thereafter exporting the same. In the latter case, he would be a trader exporting jewellery and not the manufacturer or processor. The Assessing Officer has recorded that the assessee had purchased gold from MMTC and had swapped the same for readymade jewellery by paying an extra amount and got it prepared from jewellers. Thus, the assessee was neither a manufacturer nor a processor of the jewellery exported. The C.I.T (A) had held that the assessee had purchased gold from MMTC and thereafter paid labour and other charges to the artisans who had manufactured the jewellery on job work basis as per the specifications provided by the overseas buyers to the assessee. Contention of the assessee that to be a manufacturer or processor, they need not carry on manufacturing or processing activities by employing own labour or workers was specifically raised, but not accepted. It was observed that that the assessee had swapped the gold and had procured gold jewellery from reputed manufacturers, without giving further details. The assessee, as observed by C.I.T (A), had paid fixed rate as making charges. Thus, the C.I.T (A) held that the assessee was not a manufacturer of jewellery and had also not processed gold to make jewellery/ornaments, hence was trading in jewellery.
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> 11A. The factual findings of the Tribunal is that after buying gold from MMTC, it was handed over to the job workers with design and directions to make jewellery and ornaments. The work undertaken by the job workers was under the supervision and control of the assessee. The assessee had paid labour charges to the artisans. Thus, the factual finding recorded is that the assessee had handed over gold to artisans and received the same in form of jewellery and ornaments as per the assessee"s directions and instructions.
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> 12. The contention of the Revenue that the assessee was not a processor or manufacturer of jewellery because it had engaged job workers and had not employed their own workers has to be rejected. The Delhi High Court in Orient Longman Ltd. vs. Commissioner of Income Tax, Delhi –II (1981) 130 ITR 477 (Del), had approved the view taken by the Calcutta High Court in Additional CIT vs. A. Mukherjee and Co. (P) Ltd. (1978) 113 ITR 718 (Cal.), that a publisher who got the manuscript for publication prepared after getting them printed and bound from third parties, was engaged in manufacturing activity. This was inspite of the fact that the assessee did not possess or own any printing press. This, it was held, was not necessary as long as printing and binding was done under the supervision of the assessee. It was not necessary that the

> assessee should own a printing press or be a book binder himse provided that the assessee who had acted as a publisher and got the book printed and bound from a binder who was only acting as a contractor of the assessee. In the said case, the High Court was examining whether the assessee was engaged in manufacture or processing of goods. The same view has been taken by the Bombay High Court in the case of CIT v. Neo Pharma Private Ltd. [1982] 137 ITR 879 (Bom.), CIT vs. Acrow India Ltd. [1991] 188 ITR 485 (Bom.) and CIT vs. Anglo French Drug Co. (Eastern) Ltd. (1991) 191 ITR 92 (Bom.). In these cases, it has been held that assessee was not a trader but a manufacturer/processor engaged in manufacturing and processing activities, when these activities were undertaken by a third person, under the control and supervision of the assessee.
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> In the present case we are not examining and deciding whether the respondent-assessee was an industrial undertaking, but a narrower and specific question, of distinction between a manufacturer and trader, arises for consideration. A manufacturer of jewellery or ornaments might not require huge investment in machinery etc. Mode and manner of engaging and undertaking manufacturing activity could be variable. Aforesaid decisions are relevant as they differentiate between a trader and a manufacturer/processor, on the principle of control and supervision, when the manufacturing activity is undertaken. The same test has been applied by the Tribunal.
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> 13. In view of the findings recorded above, it has to be held that sub-clause (a) to sub-section (3) to Section 80 HHC of the Act, would be applicable in view of the factual finding recorded by the Tribunal that the aforesaid work was undertaken by the job workers under the supervision and control of the assessee and under their directions/check."

16. The aforesaid decision in the case of ***Harig India Limited*** (supra) is in the context of Section 80HHC of the Act and, therefore, would not be conclusive and completely apposite. The ratio exposits, difference between a manufacturer exporter and a trader exporter. The language and purport of Section 10B of the Act is somewhat different. The term "manufacture" was defined in Explanation 3 to Section 10B prior to its substitution in 2001 by an inclusive definition to mean any process, assembling or recording of programme. Thereafter, by Finance (No. 2) Act of 2009, with effect from 1st April, 2009, the term "manufacture" has been defined in sub-section 29AB

to Section 2 to mean a change in a non-living physical object article or thing resulting in transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character or use; or bring into existence a new and a distinct object or article or thing with a different chemical composition or integral structure. The aforesaid two definitions would not be applicable to these appeals, which relate to Assessment Years 2007-08 and 2008-09. Pertinently, in Explanation 4 to Section 10AB of the Act inserted by Finance Act 2003 with effect from 1st April, 2004, the term "manufacture" or "produce" it stands elucidated would include cutting or polishing of precious or semi-precious stones. The aforesaid definition reflects and illustrates the legislative intent behind granting exemption/deduction under Section 10B and the wide scope the legislature wanted to bestow. Polishing or cutting of gem stones does not require elaborate machinery and can be done with minimal tools and a small investment. A Division Bench of this Court in ***Commissioner of Income Tax versus Lovlesh Jain***, Income Tax Appeal No. 1223/2011, decided on 20th December, 2011, with reference to Sections 10A and 10B of the Act went into the question whether conversion of standard gold into ornaments would amount to "manufacture" or "production". It was held as under:-

> "10. The word "manufacture" can be given, both a wider as well as a narrower connotation. In wider sense, it simply means to make, fabricate or bring into existence an article or product either by physical labour or by mechanical power. Given a narrower connotation it means transforming of the raw material into a commercial product/commodity or finished product which has

a new, separate entity but this does not necessarily mean that the material by which the commodity is manufactured must lose its identity. The latter connotation has been accepted and applied with some moderation/clarification in several decisions, keeping in view the context in which the word "manufacture" has been used. The Supreme Court in ***Graphic Company India Limited versus Collector of Customs***, (2001) 1 SCC 549 and ***Union of India versus Delhi Cloth and General Mills Company Limited***, AIR 1963 SC 791 has held that manufacture has to be understood to mean transformation of goods into a new commodity commercially distinct and separate, and having its own character, use and name whether it be the result of one or several processes. However, every change does not result in "manufacture" though every change in an article may be a result of treatment or manipulation by labour or/and machines. If an operation or process that renders a commodity or article fit for use, which it is otherwise not fit, the change/process falls within the meaning of the word "manufacture".

11. We may refer with profit to the Supreme Court's elucidation in ***Commissioner of Income Tax, Kerala v Messrs Tara Agencies***,[2007] 292 ITR 444 (SC). Herein the Supreme Court has turned to the definition provided in the Central Excise Act, 1944 among other relevant definitions. The relevant paragraphs of this decision are reproduced below:

"11. The term manufacture has not been defined in the Income-tax Act, 1961.

12. The term manufacture has been defined in section 2(f) of the Central Excise Act, 1944. Parts (i) and (ii) of section 2(f) read as under:-

2(f). 'Manufacture' includes any process-

(i) incidental or ancillary to the completion of a manufactured product; and
(ii) which is specified in relation to any goods in the Section or Chapter notes of the Schedule to the Central Excise Tariff Act, 1985 as amounting to manufacture".

12A. Clause (f) gives an inclusive definition of the term 'manufacture'. According to the dictionary, the term 'manufacture' means a process which results in an alteration or change in the goods which are subjected to the process of manufacturing leading to the production of a commercially new article. In determining what constitutes 'manufacture' no hard and fast rule can be applied and each case must be decided on its own facts having regard to the context in which the term is used in the provision under consideration.

13. The term manufacture has been defined by the Black Law Dictionary (5th Edition) as under: 'Manufacture : The process or operation of making goods or any material produced by hand, by machinery or by other agency; anything made from raw materials by the hand, by machinery, or by art. The production of articles for use from raw or prepared materials by giving such materials new forms, qualities, properties or combinations, whether by hand labor or machine.

14. The word 'manufacture' has been defined in Halsbury's Laws of England, 3rd Ed. Vol. 29 p.23 as under:- 'Manufacture has been defined as a manner of adapting natural materials by the hands of man or by man-made devices or machinery and as the making of an article or material by physical labour or applied power'; but the practice is to

accept as 'manufacture' a wider range of industrial activities than such a definition would suggest. It includes articles made in situ as well as articles made in a factory.

15. The Supreme Court of the United States of America has defined the term 'manufacture' a century ago in Anheuser-Busch Brewing Assn. v. United States (1907) 52 L Ed. 336. The definition has been followed in subsequent American, English and Indian cases. The definition reads as under: Manufacture implies a change, but every change is not manufacture, and yet every change in an article is the result of treatment, labour and manipulation. But something more is necessary. ..There must be transformation; a new and different article must emerge, .having a distinctive name, character or use."

12. As noticed above, Section 10A/10B is applicable when an undertaking manufactures, or is engaged in production of articles or things. The term "production" has a larger magnitude and is more ITA 1223/2011, 67/2010 and 458/2010 Page 11 expansive and liberal than the term "manufacture". The terms manufacture and produce were interpreted in the ***Commissioner of Income Tax, Bombay City versus TATA Locomotive and Engineering Company Ltd.*** (1968) 68 ITR 325 (Bom.), and it was held:-

" In its roots the word "manufacture" comes from the Latin word "manus" which means "hand" (and "manu" is the ablative of the word "manus") and the word "facere" which means "to make". In origin, therefore, the word implied the making of anything by hand, by with the passing of time and in the context of industrial development the word has acquired a number of shades of meaning. In connection with industry or in industrial

undertaking, two shades of meaning are important. In the Oxford Dictionary, vol. 6, the two shades of meaning are given as follows : (1) The first is "the action or process of making articles or material (in modern use, on a large scale) by the application of physical labour or mechanical power. " This is the most generic meaning in its application to industry or industrial undertaking or establishments. (2) There is also another more limited meaning which is found referred to in the authorities as meaning the transforming of raw material into a commercial commodity or a finished product which has a separate identity (Commissioner of Income tax v. Ajay Printery Pvt. Ltd.(1)). This shade of meaning is more appropriately used in the past participle "manufactured". See Oxford Dictionary, Vol. 6, at page 143, sense No. 1, where the meaning is "fabricated from raw material". In Aswathanarayana v. Dy Commercial Tax Officer (1) at page 801 one finds a useful compilation of meaning attached to the word "manufacture" from various dictrionaries and other sources.

Similarly, the word "produce" with reference to its meaning in industry or political economy has two different senses. In vol. 8 of the Oxford Dictionary, at page 1422, the two meaning are given as follows: "To ITA 1223/2011, 67/2010 and 458/2010 Page 12 bring forth, bring into being or existence (a) generally to bring (a thing) into existence from its raw materials or elements or as the result of a process" and " (d) To compose or bring out by mental or physical labour (a work of literature of art); to work up from raw material, fabricate, make, manufacture (material object) ".

In the Ajay Printer's case, a Division Bench of the Gujarat High Court pointed out that the word "manufacture" has a wider and a narrower connotation. In the wider sense it simply means to make, or fabricate or bring into existence an article or a product either by physical labour or by power. The word "manufacture" in ordinary parlance would mean a person who makes, fabricates or brings into existence a product or an article by physical labour or power. The other shade of meaning which is the narrower meaning implies transforming raw materials into a commercial commodity or a finished product which has an entity by itself, but this does not necessarily mean that the materials with which the commodity is so manufactured must lose their identity. Thus both the words "manufacture" and "produce" apply as well to the bringing into existence of something which is different from its components. One manufactures or produces an article which is necessarily different from its components."

13. The difference in the words "manufacture", 'production (to produce)' and "process" was examined by the Supreme Court in ***Commissioner of Income Tax, Kerala v. Tara Agencies***, (2007) 6 SCC 429. On the question of what is meant by the term „production", it has been elucidated and explained as under:-

"16. In Black's Law Dictionary (5th Edn.), the term "production" has been defined as under:

"Production.—Process or act of producing. That which is produced or made; i.e. goods. Fruit of labor, as the productions of the earth, ITA 1223/2011, 67/2010 and 458/2010 Page 13 comprehending all vegetables and fruits; the productions of intellect, or genius, as poems and

prose compositions; the productions of art, as manufactures of every kind."

17. The term "produce", as defined in New Webster's Dictionary of the English Language (Deluxe Encyclopædic Edition), is as follows: "Produce.—To bring forth into existence; to bring about; to cause or effect, esp. intellectually or creatively; to give birth to; to bear, furnish, yield; to make accrue; to bring about the performance of, as a movie or play; to extend, as a line. To bring forth or yield appropriate offspring, products, or consequences."

14. In ***Income Tax Officer versus Arihant Tiles and Marbles Private Limited***, [2010] 320 ITR 79 (SC), it was observed that cutting of marble blocks into slabs or tiles per se may not amount to "manufacture" but the activity would constitute "production". Further, when one refers to the word "production", it means a process plus something in addition thereto. Every manufacture can qualify as production but every production need not amount to manufacture. The original marble block does not remain a block when it becomes slab or a tile and undergoes polishing, etc. and, therefore, amounts to production and qualifies for deduction under Section 80IA of the Act. Even though the chemical composition or the basic material may be the same but in commercial parlance, the two products were different. In this case, the Supreme Court noticed and observed that if the ITA 1223/2011, 67/2010 and 458/2010 Page 14 contention of the Revenue is accepted, it would have negative revenue consequences as the assessees are also liable to pay excise duty, sales tax, etc. because of the processing involved, resulting in the said change. The aforesaid change was held to be sufficient. After referring to ***CIT versus N. C. Budharaja & Co.*** (1993) 204 ITR

412 (SC), it was observed that the word "production" when used in juxtaposition with the word "manufacture" takes within its ambit bringing into existence new goods by a process which may or may not amount to manufacture. The word "production" takes in all the by-products, intermediate and residual products, which emerge in the course of manufacture of goods.

15. In ***CIT versus Emptee Poly Yarn (P.) Ltd.*** (2010) 320 ITR 665, the thermo mechanical process that converts partially oriented yarn into textured yarn, which is a new and a distinct product or article was regarded as manufacture as it brings about a structural change in the yarn itself. Partially oriented yarn cannot be used in warp or weft but texturized yarn can be used. It was held that the structure, the character, the use and the name of the product are indicia, which are to be taken into account while deciding the question whether the process amounts to "manufacture" or not. We have referred to the said decision, as the chemical composition of the partially oriented yarn and ITA 1223/2011, 67/2010 and 458/2010 Page 15 the textured yarn is similar, but the use, name and character of the yarn becomes different after texturizing.

16. In the present case, manufacture as well as production of goods, articles or things is covered under Section 10A/10B. The activity for converting gold bricks, biscuit or bars, into jewellery amounts to "production or manufacture" of a new article. The gold, silver or platinum in bar, biscuit or brick form, is converted by manual labour and by the use of implements/tools or by machinery, culminating into an entirely new article/thing called jewellery or ornaments. Jewellery is a wearable item and is used by both

> men and women. This process has been referred to above in paragraph 6.4, while adverting to the factual matrix in the case of Shashi Kant Mittal. Jewellery/ornaments in common parlance or in commercial terms has a distinct identity, treated as a new article and not the same as raw or standard gold in the form of bricks, biscuits or bars. As a result of the said processing, a commercially different saleable product comes into existence. Jewellery has a distinctive name, character and use. It can no longer be regarded as the original commodity, has separate consumers and is a new commercial commodity. The activity of the respondent assessee amounts to "manufacture or production" and, therefore, qualifies for deduction under Section 10A/10B."

17. The aforesaid passage refers to a number of decisions on the said subject. However, we would like to refer to the judgment of the Supreme Court in ***Commissioner of Income Tax versus Oracle Software India Limited***, (2010) 320 ITR 546, in which the controversy was whether the assessee was a manufacturer and thus entitled to deduction under Section 80 IA. The Supreme Court interpreted the term "manufacture" and held that the process of commercial duplication of software requires four steps. Installation/transfer of virtual image of the software on the recordable media with checking of integrity would qualify as "manufacture". It was held that manufacture implies change, but every change is not manufacture despite the fact that every change in an article is a result of treatment of labour and manipulation. If the operation/process renders a commodity or article fit for use for which it is otherwise not fit, the operation/process falls within the meaning of word "manufacture".

18. In ***CIT versus N.C. Budharaja & Co.*** (1993) 204 ITR 412, which has been noticed in ***Lovlesh Jain*** case (supra), the Supreme Court at page 424 referred to the principle that one must keep in mind the context, since a word takes its colour from the context. In ***N.C. Budharaja's*** case (supra) it was observed that the word "production" has wider connotation than the word "manufacture" and illustratively every manufacture could be categorised as production, but not vice-a-versa. In the present context, in Section 10B, the word "production" has been used in addition to the word "manufacture" and also an expanded scope and ambit is envisaged for the said term in the context of Section 10B in Explanation 4. It would be incongruous and inappropriate in the context of Section 10B of the Act to hold that the respondent-assessee, an 100% export oriented unit, who had refurbished a mini cement plant in Zambia and established a mini steel mill in Kazakhstan, were not engaged in "manufacture" or "production" of articles or things. The fallacy in the argument raised by the Revenue is apparent. It is accepted that in case the mini steel plant and refurbished cement mill had been completely assembled in the unit in Noida and exported as such, the assessee would qualify and would be a manufacturer or a person engaged in production of articles or things. However, benefit under Section 10B, it is asserted by the Revenue, should be denied for what was exported were separated or disassembled parts of the mini cement and steel plant/mill, as it was not possible to export after fabrication and assembly the entire plant/mill itself. The said fabrication and assembly had to be undertaken in view of size and logistics at the location where the plant/mill had to be upgraded or set up. The

aforesaid reasoning and ratiocination is obdurate and deflates t object and purpose of Section 10B of the Act. Such narrowness and curtailment should not be accepted. Export of goods and things can take various forms and Section 10B accepts and admits such interpretation.

19. In ***CIT versus Gwalior Rayon Silk Manufacturing Company Limited***, (1992) 196 ITR 149 (SC), it was held that an expression used in taxing statute should be ordinarily understood in the sense it harmonises with the object of the statute to effectuate the legislative intention. If the language is plain and unambiguous, one can look fairly at the language used and interpret it to give effect to the legislative intent. Nevertheless, tax laws have to be interpreted reasonably and in consonance with justice adopting a purposive approach. Contextual meaning has to be ascertained and given effect to.

20. The Kerala High Court in ***Girnar Industries versus Commissioner of Income Tax***, (2011)338 ITR 277 (Kerala) with reference to Section 10A of the Act referred to the definition of the term "manufacture" in Chapter IX of Exim Policy clause 9.30 and noted that the definition of the term "manufacture" contained in Section 2(r) of the Special Economic Zones Act, 2005 was incorporated later under Section 10AA of the Act with effect from 10th February, 2006. The said definition includes make, produce, fabricate, assemble, process, etc. by hand or by machines, a new product having a distinct name, character, use and would also include

processes such as refrigeration, cutting, polishing, blending, repa , re-making, re-engineering, etc.

21. In view of the aforesaid discussion, the substantial question of law framed above is answered in favour of the respondent-assessee and against the appellant-Revenue. In the facts of the case, there will be no order as to costs.

(SANJIV KHANNA)
JUDGE

(V. KAMESWAR RAO)
JUDGE

February 5th, 2015
Kkb/VKR