



**IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION**

INCOME TAX APPEAL NO. 4508 OF 2010

The Commissioner of Income Tax-7
Room No. 611, 6th floor,
Aayakar Bhavan, M.K.Road,
Mumbai – 400 020.

..Appellant

versus

M/s. Schmetz India Pvt. Ltd.
E-218, Vashi International Infotech Park,
2nd floor, Vashi Railway Station,
Mumbai – 400 073.

..Respondent

Mr. Arvind Pinto for the Appellant.

Mr. F.V.Irani alongwith Mr.Atul K. Jasani for the
Respondent.

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**CORAM : S.J.VAZIFDAR &
M.S.SANKLECHA, JJ.**

DATE : 4th September, 2012

JUDGMENT (PER M.S.SANKLECHA, J) :

1 This appeal by the Revenue under Section
260A of the Income Tax Act, 1961 ('the Act')
challenges the order dated 30.07.2008 of the Income
Tax Appellate Tribunal ('the Tribunal') in ITA No.
7629/MUM/07 relating to the assessment year 2004-
2005.

2 Being aggrieved by the order dated 30.07.2008 of the Tribunal, the Revenue has formulated the following questions of law for consideration of this court.

“Whether on the facts and in the circumstances of the case and in law the Tribunal was justified

A) in coming to the conclusion that there was nothing on record to show that the profits arrived at by the assessee in respect of the 10A unit carrying on the business of manufacturing Industrial Sewing Machine Needless was not in the normal course of its business and that the abnormally high profit was due to extraordinary arrangement between the assessee and the German company entered into only with a view to boost the profits of assessee and therefore allowing deduction of Rs.20,54,27,335/-?

B) in holding that the there was no material available with the A.O. to estimate the



profits of the 10A unit eligible for deduction invoking the provisions of S.80 IA(10) read with S.10A(7) of the Act was based on proper and reasonable appraisal of the material available on record?

C) in holding that the deduction under S. 10A of the Act has to be computed without setting off of the loss from the trading unit against the profits of the export oriented unit entitled to deduction under S.10A of the Act.?

3 The respondent-assessee is a wholly owned subsidiary of a German Company. The respondent-assessee has two divisions in India. One division at Kandla in the Kandla Free Trade Zone, is engaged in the manufactures and export of industrial sewing machine needles. The other division at Mumbai is engaged in trading in industrial sewing machine needles. The manufacturing division at Kandla exports its entire production of industrial machine needles to its holding/principal company in

Germany. The industrial sewing machine needles imported by the respondent from Germany are of a variety different from those manufactured and exported by it from the Kandla division.

4 The respondent-assessee for the assessment year 2004-2005 declared an income of Rs.20.54 crores from its manufacturing division at Kandla and claimed 100% deduction under Section 10A of the Act. During the course of the assessment proceedings, the Assessing Officer was of the view that abnormal profits had been declared in respect of the Kandla division, only in view of the income therefrom being exempt under Section 10A of the Act. This view of the Assessing Officer was strengthened by the fact that the trading division at Mumbai showed a loss of Rs.70.29 lacs. Consequently, the Assessing Officer called upon the respondent-assessee to explain the abnormal profits at Kandla division and also why the provisions of Section 10A(7) read with Section 80IA(10) of the Act should not be invoked. The above provision

empowers an Assessing Officer to redetermine the profits which may be reasonably deemed to have arisen from such eligible business in case he is of the view that the undertaking has declared more than ordinary profits. The respondent-assessee responded to the query and pointed out that the reasons for higher profits were as under :

"i) The entire production of the company is being exported to Associated Enterprises and accordingly there is no risk of unsold finished goods. This results in the company concentrating mainly on the production side.

ii) The company does not have to wait for the orders on the basis of which the production line is determined. But the company has large variety of the products to be manufactured for the Associated Enterprises. This results in machinery working at full capacity which results in the best results.

iii) The sales of the company being secured no marketing efforts or cost is involved.

iv) The sales are affected in bulk packing conditions, which saves the cost of packing materials too.

v) The basic raw material is being imported from the Associated Enterprises which results in problem free production and no chances of major rejection which could account for any losses.

vi) The Associated Enterprises is 100% holding equity and provides all finance arrangements. Thus, there is no interest burden on the company for its working capital requirements."

5 The Assessing Officer placed reliance upon the chart submitted by assessee to show the details of expenses, gross profits etc. arising in comparable cases. On the basis of the above chart, the Assessing Officer concluded that the profits of the business of the respondent-assessee for the purpose of deduction under Section 10A has to be arrived at by adopting 60% gross profit ratio as against 77.91% shown by the assessee. The deduction therefore under Section 10A of the Act

was restricted by the Assessing Officer to Rs.13.17 crores and the balance of Rs.6.83 crores was brought to tax under the head 'Income from Other Sources'. Further, the Assessing Officer also held that the trading loss of Rs.70.29 lacs from its trading division at Mumbai should be first set off against manufacturing income at Kandla division before deduction under Section 10A of the Act can be claimed by the Kandla division.

6 Being aggrieved, on both the above counts the respondent-assessee filed an appeal to the Commissioner of Income Tax (Appeals). By an order dated 24.08.2007, the Commissioner of Income Tax (Appeals) held that the gross profit ratio of 60% adopted by the Assessing Officer as against 77.91% gross profit ratio declared by the assessee was reasonable. The profits in excess of the above was correctly brought to tax as 'income from other sources'. So far as the second issue is concerned, the Commissioner of Income Tax (Appeals) held that before exemption of income under Section 10A of the

Act is availed, the respondent-assessee must set off the losses of other units against the income of 10A units and only the balance amount available thereafter would be allowed deduction under Section 10A of the Act. Thus, the Commissioner of Income Tax (Appeals) upheld the order of the Assessing Officer.

7 In second appeal, the Tribunal by its order dated 30.07.2008 held that merely because an assessee makes extraordinary profits, it would not lead to the conclusion that the same was organised/arranged. This according to the Tribunal would penalize efficient functioning of the unit. The Tribunal was of the view that the Assessing Officer has not been able to prove that any arrangement had been arrived between the parties which resulted in extraordinary profits to the respondent-assessee's manufacturing division at Kandla. Consequently, the reworking of the profits by the Assessing Officer was not proper. The Assessing Officer had completely ignored the fact

that as the entire production of the respondent-assessee was being sold to its German principal/holding company, they did not have any expenses of marketing etc. This resulted in it being focused in reducing the cost of operation, which resulted in higher profits. The Tribunal therefore, held that the profits derived by the respondent-assessee from its export division at Kandla should be taken at Rs.20.53 crores and considered for relief under Section 10A of the Act. So far as, the second issue is concerned namely whether Section 10A deduction by Kandla division should be claimed after setting off the loss of its trading division at Mumbai or prior thereto the Tribunal held that the deduction to the Kandla division would be available on its profits under Section 10A of the Act. The losses suffered by Mumbai division (trading division) should not be set off against the profits of Kandla division before claiming the deduction under Section 10A of the Act.

8 So far as questions (a) & (b) are concerned, we find that the Tribunal has considered the entire evidence and on facts come to the conclusion that the profits earned by Kandla division of the respondent-assessee is not abnormally high due to any arrangement between the respondent-assessee and its German Principal. The Tribunal correctly held that extraordinary profits cannot lead to the conclusion that this is an arrangement between the parties. This would penalize efficient functioning. Further, the authorities have also recorded a finding that the industrial sewing machine needles imported and traded by the Mumbai division are different from those manufactured & exported by the Kandla division. Consequently, this also negatives any arrangement between the parties to show extraordinary profits in respect of its Kandla division so as to claim deduction under Section 10A of the Act. These are findings one of fact. The appellant-revenue have not been able to show that the findings are perverse or arbitrary. In the

circumstances, questions (a) and (b) as formulated by the appellant/revenue do not raise substantial questions of law in the present facts and are therefore dismissed.

9 So far as, question (c) is concerned, both the respondent-assessee and appellant-revenue agree that the issue is covered in favour of the respondent-assessee by the decision of this court in ITA (Lodging) No. 1237 of 2011 in CIT v. Black & Veatch Consulting Pvt. Ltd. dated 09.04.2012. Therefore, question (c) is answered in the affirmative i.e. in favour of the respondent-assessee and against the appellant-revenue.

10 The appeal is disposed of in above terms. No order as to costs.

(M.S. SANKLECHA, J.)

(S.J.VAZIFDAR, J.)