Reportable/Non-reportable

IN THE HIGH COURT OF HIMACHAL PRADESH AT SHIMLA

ON THE DAY OF JULY, 2022

BEFORE

HON'BLE MS. JUSTICE SABINA

&

HON'BLE MR. JUSTICE SATYEN VAIDYA

INCOME TAX APPEAL No. 24 of 2010

Between: -

COMMISSIONER OF INCOME TAX, SHIMLA.

....APPELLANT

(BY MR. VINAY KUTHIALA, SENIOR ADVOCATE WITH MS. VANDNA KUTHIALA, ADVOCATE.)

AND

M/S USHA INFRASYSTEMS, 21-D, SECTOR-1, PARWANOO THROUGH ITS PARNTER KARAN SOOD.

..RESPONDENT

(MR. VISHAL MOHAN, ADVOCATE WITH MR. ADITYA SOOD, ADVOCATE)

INCOME TAX APPEAL No. 6 of 2012

Between: -

COMMISSIONER OF INCOME TAX, SHIMLA.

....APPELLANT

(BY MR. VINAY KUTHIALA, SENIOR ADVOCATE WITH MS. VANDNA KUTHIALA, ADVOCATE)

AND

M/S USHA INFRASYSTEMS, 21-D, SECTOR-1, PARWANOO THROUGH ITS PARNTER KARAN SOOD.

..RESPONDENT

(MR. VISHAL MOHAN, ADVOCATE WITH MR. ADITYA SOOD, ADVOCATE)

Reserved on: 12.07.2022
Decided on: .07.2022

These appeals coming on for hearing this day, ***Hon'ble Mr. Justice Satyen Vaidya***, passed the following:-

J U D G M E N T

Both the appeals have been heard and are being decided together as common questions of law and facts arise therein.

2. Respondent in both the appeals (hereinafter referred to as the 'assessee') had begun production of Foundation Anchor Rods for Windmills (for short, "Anchors") w.e.f. 29.06.2004 in Industrial Area Parwanoo, District Solan, H.P.

3. The assessee, for the first time, claimed 100% deduction on the income under sub-clause (ii) of Sub Section (2) of Section 80IC of the Income Tax Act, 1961 (for short 'the Act") for the assessment year 2005-06. The

Assessing Officer denied the deduction so claimed and vide assessment order dated 30.11.2007 passed under Section 143(3) of the Act assessed total income of assessee at Rs.1,66,61,240/-. The assessee assailed the assessment order in appeal No. IT/212/2007-08/SML. The appeal of assessee was dismissed by CIT(A), Shimla on 29.04.2009. The assessee filed further appeal before the ITAT, Chandigarh which was allowed on 30.11.2009 as ITA No. 499/Chd, 2009. Revenue assailed the order dated 30.11.2009 passed by the ITAT Chandigarh in ITA No. 15/2010 before this Court, which later came to be withdrawn by the Revenue on 22.12.2021 on account of involvement of low tax effect.

4. The point in issue in the aforesaid litigation was whether the process undertaken by the assessee in its industrial unit at Parwanoo amounted to 'manufacture' or 'production' of the Anchors so as to qualify the requirements of Section 80IC of the Act? Whereas, the Assessing Officer and CIT(A) concurrently held that since the substantial process involved in production of Anchors was being got done by the assessee from Ludhiana on work order basis and only a small part of it was being done at Parwanoo, the assessee could not be said to have the

necessary qualification to avail deduction under Section 80IC of the Act. The ITAT, however, reversed such findings and held the assessee eligible for deduction under the aforesaid provision of the Act.

5. The assessment proceedings for the assessment year 2006-07 also met the same fate before the AO, CIT(A) and ITAT. ITA No. 24/2010 arising therefrom is one of the matters under adjudication herein. The Assessing Officer again had held the assessee to be not entitled for the deduction under Section 80IC for the same reasons as were recorded in assessment order dated 30.11.2007. CIT(A) vide its order dated 06.11.2007 in ITA No. 244/08-09/SML concurred with the assessment order dated 21.11.2008. The ITAT reversed the order of CIT(A) vide its order dated 29.01.2010 in ITA No. 1158/Chd/2009.

6. For the assessment year 2007-08 the Assessing Officer, vide his order dated 30.12.2009 again held the assessee not entitled to deduction under Section 80IC. The CIT(A), in appeal No. IT/503/2009-10/SML preferred before it by the assessee, this time reversed the assessment order dated 30.12.2009. The ITAT concurred with the order of CIT(A) and accordingly dismissed the ITA No. 78/Chd/2011 filed by the Revenue vide its order dated

03.03.2011. Revenue has further assailed the aforesaid order dated 03.03.2011 of ITAT in ITA No. 6/2012 before this Court, which is the other appeal decided herein.

7. The substantial questions of law framed by this Court in ITA No. 24 of 2010 and ITA No. 6 of 2012 are common and read as under: -

1) *Whether the process of threading and painting of anchor rods carried out by the assessee at Parwanoo amounted to manufacture or production, and consequently whether the assessee was eligible for deduction u/s 80IC of the Income Tax Act ?*
2) *Whether the making of anchor rods by third parties in job work basis could be considered as part of the manufacturing operations of the assessee, especially when such job work was not carried out under the direct control and supervision of the assessee?*
3) *Whether the ITAT disregarded the mandate of section 80IA (10) read with section 80IC(7) of the I.T. Act and erroneously held that the entire profit declared by the assessee was allowable as deduction u/s 80IC?*
4) *Whether ITAT has misconstrued and misunderstood the facts on record while setting aside the clear finding that the profit had been inflated by the assessee for the purpose of deduction u/s 801C.*

8. We have heard Mr. Vinay Kuthiala learned Senior Advocate with Mrs. Vandana Kuthiala Advocate for the appellants and Mr. Vishal Mohan Advocate learned counsel for the assessee and have also gone through the records.

Questions Nos. 3 and 4

9. Questions Nos 3 and 4, as noted above, are being taken up for consideration by us in the first instance. The consideration of these questions requires us to briefly recapitulate the material on record.

10. The Assessing Officer had found that the assessee, in the assessment year 2006-07 had declared total sale of Rs. 15,63,28,569/- and had shown profit of Rs.6,10,30,054/- which gave gross profit rate at 39.04% and net profit rate at 32.54%. The Assessing Officer, by making a comparison between the assessee and M/s Kay Pee Industries in respect of their sales during the relevant year and expenses incurred, held that the assessee had not fully debited expenses and profit shown by the assessee was not acceptable. Further, it was held by the Assessing Officer that since nothing was shown to have paid by the assessee to its sister concern for the technical know-how and goodwill and marketing facilities, 5% each of the total sales of the assessee were ordered to be deducted as profits were shown by the assessee were held to

be inflated to that extent. Thus, a sum of Rs.1,55,32,856/- was ordered to be treated as assessee's income from undisclosed sources. Thus, the Assessing Officer had concluded that there existed direct relation between the assessee and Kay Pee Industries as far as the enterprise of assessee claiming manufacture of Anchors at Parwanoo was concerned and as such provision of section 80IA(10) of the Act was applied.

11. Further, a sum of Rs.2,40,000/- on account of salary to partners and Rs.20,71,949/- on account of interest on capital were reduced from the profit of the assessee. The Assessing Officer also found shortage in stocks worth Rs.39,948/- and the same was also treated as income of assessee for the year under consideration. In this manner, total income of the assessee was assessed at Rs.5,11,16,590/-.

12. While passing the assessment order dated 21.11.2008 for assessment year 2006-07, the Assessing Office had further held that the threaded rods along-with nuts and bolts were being manufactured by M/s Kay Pee Industries, a sister concern of assessee. The part relating to hardening, straightening and threading of rods had been transferred to the assessee by the sister concern which itself continued to

manufacture nuts and bolts. On the basis of these findings, the Assessing Officer held that it clearly was a case of splitting or re-construction of business already in existence and hence, the assessee had violated the conditions laid down in Section 801C (4) (i) of the Act.

13. In his Assessment Order dated 30.12.2009 for AY 2007-08, the Assessing Officer did not touch the above noted factors and had proceeded to deny the claimed deductions under section 80IC on the simple premise that the process undertaken by the assessee did not qualify to be either 'manufacture' or 'production'.

14. The CIT(A) upheld the findings returned by the AO but ITAT reversed the same. Negating the applicability of Section 801A (10) of the Act to the facts of the case, ITAT held that the order of Assessing Officer to that effect was not sustainable as no discrepancy had been pointed out in the books of account and such books of account of the assessee had not been rejected under Section 145 of the Act. The Assessing Officer was held to have arrived at his conclusions merely on estimation. The basis for estimation of the GP & NP ratio that too in comparison with the M/s Kay Pee Industries was not held to be correct as there was no similarity in the products manufactured by two different concerns. The

Assessing Officer, according to the impugned order passed by the ITAT, had estimated profits of assessee on estimation, conjectures and surmises. No basis was found in documents in assuming declaration of inflated profits by the assessee. Further, the deduction at the rate of 5% of total sales on account of non-payment of charges to M/s Kay Pee industries for technical know-how and deduction of equivalent amount on account of non-payment of charges for goodwill etc., to the said concern, as concluded by the Assessing Officer, have also been held to be without any basis.

15. Learned counsel for the appellant has not been able to show that findings recorded by the ITAT, as noticed above, were against the records or were perverse. The ITAT being the final fact finding authority, in our considered view, has drawn the conclusions on the basis of records. There is nothing in the order of Assessing Officer that the books of account of assessee were rejected. In the Assessment Order passed for Assessment Year 2006-07 the Assessing Officer had only observed that such books were not reliable, which cannot be taken to compliance of Section 145 of the Act. Further, the orders passed by Assessing Officer with respect to capping of profits earned by the assessee at 7% only on the alleged basis of comparison of accounts of Kay Pee Industries coupled with

deduction of amount equivalent to 10% of the total sales towards non-payment of know how charges and towards usage of goodwill etc. have rightly been rejected by the ITAT being without any legal material or evidence. The Appellate Tribunal found nothing on record which could warrant the conclusions drawn by the Assessing Officer. To that extent, we are in agreement with the findings recorded by the ITAT. Questions No. 3 and 4 are answered accordingly.

Questions Nos. 1 and 2:

16. Now coming to questions Nos. 1 and 2, the process undertaken by the assessee was not considered by assessing officer to be that of manufacture or production of Anchors for the reasons *firstly* that the process involved only threading of rods on both ends and its assembly with nuts and washers, therefore, the basic property of rod was not changed and *secondly* only small part of the entire process was undertaken at Parwanoo. Though the CIT(A) had concurred with the order of Assessing Officer for AY 2006-07, the said appellate authority had reversed the same for AY 2007-08. The ITAT, however, held the process undertaken by the assessee to be "manufacturing and production"

17. The Three Judges Bench of the Apex Court in case ***Aspinwall and Co. Ltd.*** v. ***Commissioner of Income Tax,***

251 ITA 323 has expounded that the word 'manufacture' has not been defined in the Act. In the absence of definition of the word "manufacture, it has to be given a meaning as is understood in the common parlance. It has to be understood as meaning the production of articles for use from raw or prepared materials by giving such materials new forms, qualities or combinations whether by hand labour or machines. If the change made in the articles result in a new and different article, then it would amount to a manufacturing activity."

18. In ***Commissioner of Income Tax-V, New Delhi*** vs. ***Oracle Software India Limited, (2010) 2 SCC 677***, the Hon'ble Apex Court has further expounded as under: -

> *"12. In our view, if one examines the above process in the light of the details given hereinabove, commercial duplication cannot be compared to home duplication. Complex technical nuances are required to be kept in mind while deciding issues of the present nature. The term "manufacture" implies a change, but, every change is not a manufacture, despite the fact that every change in an article is the result of a treatment of labour and manipulation. However, this test of manufacture needs to be seen in the context of the above process. If an 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 the word "manufacture".

19. In ***Income Tax Officer*** vs. ***Arihant Tiles and Marbles, 2010(2) SCC 699***, it has been noted that the expression used in Section 80IA - which is analogous to the expression used in Section 801B, which uses words manufactures or produces, as applicable to the present case mandates the Court to consider not only word “manufacture” but also the connotation of word “production”. Having noted this position, the Court went on to observe that the said expressions have wider meaning as compared to the word “manufacture”. Further, the word “production”, means manufacture plus something in addition thereto.

20. A Division Bench of this Court in ITA No. 2 of 2009, in case titled as ***Commissioner of Income Tax, Shimla*** vs. ***M/s Doon Valley Rubber Industries*** having taken notice of the various precedents has held that the test for determining whether manufacture can be said to have taken place is whether the commodity, which is subjected to a process, can no longer be regarded as original commodity, but is recognized in trade as a new and distinct commodity. Further, the word “production”, when used in juxtaposition

with the word “manufacture” takes in 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 products and residual products, which emerge in the course of manufacture of goods.

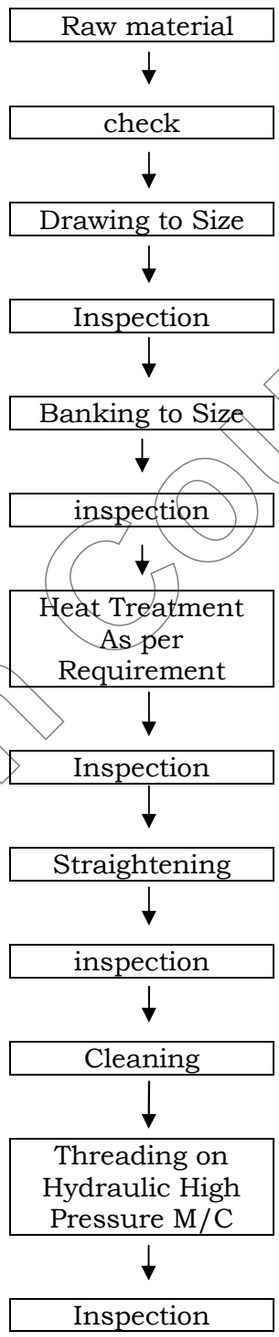
21. Keeping the aforesaid exposition of law in view, it will be too absurd to say that since the raw material for the product in question was the rod and the final product was also the rod, hence was not “manufacturing or production”. The flow chart relied upon by the Assessing Officer itself suggests a series of processes undertaken before the raw material could be converted into the final product i.e. the Anchors used for windmills. The raw material might have been a raw steel rod but had to undergo the different processes like drawing to size, blanking to size, heat treatment as per requirement, straightening, cleaning, threading with hydraulic high pressure, assembly of nut and washers and asphalt coating before it took the final shape of foundation anchor. The change contemplated in ***Aspinwall (supra)*** cannot be taken to mean that it would always imply a production of an article from nothing. There has to be some raw material for production and in the case in hand, it was raw steel rods, which in its original form could not be used as foundation

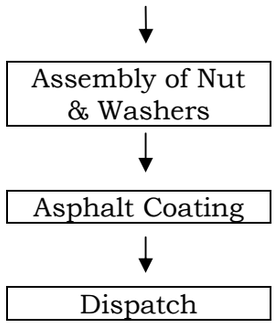
anchors for windmills. Thus, the ITAT has rightly come to the conclusion that production of foundation anchor for windmills by the assessee was a manufacturing process.

22. As noticed *supra*, there was yet another perspective that had weighed with the Assessing Officer for declining the benefit of section 80IC to the assessee for both the assessment years i.e. 2006-07 and 2007-08. It was held that the enterprise of assessee was not involved in the manufacture or production of Anchors at Parwanoo. Such finding was based on the premise that substantial work in the entire process of production was got done by the assessee from Ludhiana in Punjab by outsourcing the jobs. Only minimal job was given effect to at Parwanoo which included threading of rods on both the ends, assembly of nuts/washers and application of asphalt coat thereon. The Assessing Officer, for arriving at such conclusion, had taken into consideration the findings of survey, report of Chartered Engineer, statements of partners of assessee recorded under Section 131 of the Act etc. Thus, there was clear finding of fact recorded by the Assessing Officer that only small part of entire process involved in production of the Anchors was done at Parwanoo and that by itself could not be considered

sufficient to hold that the assessee was engaged in manufacture or producing the end product at Parwanoo.

23. The Assessing Officer had relied upon the following flow chart relating to manufacture of Anchors by the assessee:-





24. Thus, the Assessing Officer had held that the process from purchase of raw material to straightening, as shown in the above-mentioned flow chart, was got done by the assessee at Ludhiana. It was only the threading, assembly of nut and washers and asphalt coating that was done at Parwanoo. In such view of the matter, according to Assessing Officer, the assessee could not be said to be manufacturing or producing the foundation bars/anchors at Parwanoo so as to claim benefit under Section 80IC of the Act.

25. The finding of fact recorded by the Assessing Officer to above effect were concurred by the CIT (A) in ITA No. 24 of 2010 and reversed in ITA No. 6 of 2012. Though the ITAT had also concurred with the findings of fact that most of the work constituting production of Anchors was got done by the assessee from Ludhiana by outsourcing the jobs, it, nevertheless, held that the assessee was involved in manufacture and production of Anchors. The findings by the ITAT in this behalf have evidently been returned without

going into the question as to whether assessee was not entitled for deduction under Section 80IC merely by indulging into the small part of process at Parwanoo out of the entire lengthy process of production and also consequent necessary legal implication arising therefrom.

26. Section 80IC of the Act allows deduction from the profits and gains in computing the total income of the assessee in specific cases enumerated in said provision. The assessee should be an undertaking or enterprises, which had begun to manufacture or produce any article or thing not being an article or thing specified in 13th schedule, between 07.01.2003 to 01.04.2012 in an Industrial Area notified by the CBDT. In the State of Himachal Pradesh, the industrial area of Parwanoo was so notified by the CBDT vide Notification No. 273/2003 dated 04.11.2003.

27. The purpose of incorporation of Section 80IC manifestly was to invite long term investment, entrepreneurship etc. in the areas which were industrially backward. The incentive of deduction from the income generated from such enterprise for the limited years could not be used to negate the very purpose of the inclusion of Section 80IC. This facility could not be allowed to be used to camouflage the production by making only small investment in the areas specified in

Section 80IC on one hand and abandon the production after lapse of incentive period on the other. The very small quantum of capital investment made by the assessee in establishing its unit at Parwanoo had also weighed with the Assessing Officer as one of the reasons to hold as above.

28. In view of this matter, the term 'manufacture' or 'produce' used in Section 80IC has to be construed in the true context of the object and purpose of the said provision. The ITAT has failed to consider this important aspect which, in our considered view, necessarily was mixed question of fact and law required to be decided by the Appellate Tribunal in exercise of jurisdiction vested in it under law. The substantial questions of law at Serial No. 1 and 2 are answered accordingly.

29. Accordingly, ITA 24 of 2010 and ITA 6 of 2012 are partly allowed. Impugned orders dated 29.1.2010 in ITA 1158/CHD/2009 and dated 3.3.2011 in ITA 78/CHD/2011 and also the findings recorded by the ITAT in both the appeals, only to the extent of holding the assessee involved in 'manufacture' or 'production' of "Anchors" without considering the effect and implication of very small quantum of work done at Industrial Area Parwanoo, are set aside. Both

the appeals are remanded back to ITAT Chandigarh to decide afresh in terms of observations made hereinabove.

30. The appeals are disposed of accordingly. All pending miscellaneous application(s), if any, shall also stand disposed of.

(Sabina)
Judge

July , 2022
(naveen)

(Satyen Vaidya)
Judge