

(2013) 07 MAD CK 0305

In the Madras High Court

Case No : Tax Case (Appeal) No's. 299, 804 and 805 of 2010 and 342 of 2012

Commissioner of Income Tax

APPELLANT

Vs

M/s. Deco De Trend

RESPONDENT

Date of Decision : 02-07-2013

Acts Referred:

Income Tax Act, 1961 — Section 10B, 10B(2)(ii)(iii), 2(29)BA, 35B(1A)

Citation : (2014) 264 CTR 78 : (2014) 360 ITR 1

Hon'ble Judges : K.B.K. Vasuki, J;Chitra Venkataraman, J

Bench : Division Bench

Advocate : J. Narayanasamy, for the Appellant; B. Kumar, S.C. for T. Chezhiyan, for the Respondent

Judgement

Chitra Venkataraman, J.—The issues raised in the above Tax Case (Appeals) filed by the Revenue as against the order of the Income Tax Appellate Tribunal are identical in respect of the self-same assessee. Following are the questions of law arise for consideration in the above Tax Case (Appeals):-- 1. Whether on the facts and circumstances of the case, the Tribunal was right in deciding the issue of manufacture contrary to law laid down in Commissioner of Income Tax, Kerala Vs. Tara Agencies,

(ii) Whether on the facts and circumstances of the case, the Tribunal was right in finding "splitting up" contrary to Section 10B(2)(ii)(iii) of the Income Tax Act and Commissioner of Income Tax, Delhi Vs. Hindustan General Industries Ltd.,

T.C. (A) No. 299 of 2010 relates to the assessment year 2005-2006. T.C. (A) Nos. 804 of 2010 and 805 of 2010 relate to the assessment years 2004-05 and 2006-07 respectively and T.C. (A) No. 342 of 2012 relates to the assessment year 2008-09. The Tribunal passed separate orders for the assessment years 2005-06 and 2008-09 and common order for the assessment years 2004-05 and 2006-07. Since the facts are common, for convenient sake, we are referring to the facts relating to T.C. (A) No. 299 of 2010.

2. The assessee is a partnership firm. In the returns filed, it claimed deduction u/s 10B of the Income Tax Act in respect of the income earned on the export of handicraft items of dried flowers and parts of plants. Admittedly, the assessee is a 100% EOU having three units at Mananjery, Kunrathur and Moonramkattalai. There is also a closely held private limited company in Kolkata, by name, M/s. Dry De Fashions Private Limited, in which three of the partners in the assessee firm are Directors. It is stated that the company also carries on business on the same line, namely, manufacturing and exporting dry flower and potpourri. The said Private Limited Company is not a 100% EOU.

3. In considering the claim for deduction u/s 10B of the Income Tax Act, the Assessing Officer called for certain details with reference to the manufacturing activity undertaken for export of handicraft items of dried parts of plants. In the manufacturing flow chart given by the assessee, it was stated as follows:

Raw materials are first cleaned, graded and sized up with scissors and hand tools. The graded raw materials are according to the creative requirements of the product are bleached, washed and coloured with dip in process and sun dried. Lacquer is applied wherever required on the above processed raw materials. After the above preparation, the items again depending upon final creative design requirements are cut and drilled upon with hand tools.

Now these processed materials act as raw materials for the various designer products. These are now bunched together and moulded in various primitive shapes, or made as handmade flowers by applying various hand cutting skills, gluing techniques and sun drying.

The above semi finished items which are again sorted and creative design is applied for the manufacture of the products as per the specific requirements of the customers. The above products wherever required are perfumed and added glitter as per the product design to achieve a creative finish.

After the products are manufactured, the first level novelty and decorative packaging is applied on the product.

Products are suitably grouped and labeled as per customers requirements. After the individual pieces of the products are ready, one more level of packaging for display in the retail departmental chain stores or the retail exclusive decor stores is carried out, wherever required. A final inner and outer corrugated box packaging is carried out for export purposes.

Packed products are fumigated as per the legal and customer country specific requirements.

Products are stuffed in containers and shipped for exports.

The details of the finished goods manufactured by the assessee were as follows:

1. Bouquets 2. Potpourris 3. Garlands 4. Home and Office decor arrangements 5. Wall Decors 6. Floor Decors 7. Kitchen Decors 8. Window Decors 9. Christmas

Wreaths 10. Christmas Tree ornaments and 11. Gift Sets.

The Assessing Officer, however, referred to the website of the assessee, which gave the product catalogue, as follows:

1. Dried flowers 2. Sola (Soft wood) 3. Potpourri 4. Sea shells 5. Stones 6. Ready to sell Wreaths, bouquets, pot arrangement, photo frames, wall frames, garland 7. Incense sticks 8. Aroma gifts and 9. Aroma therapy.

4. Based on this, the Assessing Officer made an analysis of the shipments made by the assessee. The invoice gave the description on decorative items of dried flowers. In the invoices, the botanical names of the flowers, plant parts and sea shells were mentioned. From the purchase bills, it was found that the assessee had obtained dry flowers, fern, grass, bajra sticks, palm fruits etc. from West Bengal. On going through the nature of activity undertaken, the Assessing Authority came to the conclusion that there was no manufacturing activity done, as had been claimed by the assessee. Referring to the decision reported in Commissioner of Income Tax, Kerala Vs. Tara Agencies, the Assessing Officer held that out of 13 steps mentioned by the assessee, 8 steps involved labeling, bar coding and packing. The raw materials used as per the assessee's flow chart showed plant parts, sea shells and stone; perfumes, processing chemicals, bleaching and cleaning liquid and bonding materials, glitters and metallic powders. In the background of the nature of activity, particularly in making bouquets, Potpourri, Wreaths, Bunches, Garlands and Hobby bags, the Assessing Officer came to the conclusion that there was no manufacturing of any goods, to qualify for 100% deduction u/s 10B of the Income Tax Act.

5. On the question that the assessee firm was formed by splitting up or the reconstruction of a business already in existence to disqualify the claim as per Section 10B 2(ii) of the Income Tax Act, the Assessing Officer held that the workers in the pay rolls of the company were also employees of the assessee firm; that the assets of the company were utilised by the assessee firm; although the assessee pointed out that the company was dealing in base or low category products and the assessee firm in premium product line and hence, there was no such thing as splitting up of the company in two, yet, the business of the company was split up into two; consequently the firm was formed through the division and splitting up of a business already in existence. Thus, as per Section 10B(2)(ii) of the Income Tax Act, the assessee was disqualified from claiming deduction u/s 10B of the Income Tax Act. Aggrieved by this, the assessee went on appeal before the Commissioner of Income Tax (Appeals).

6. On going through the various processes involved and the activities undertaken by the assessee to bring out the final product to marketable condition, the Commissioner of Income Tax (Appeals) held that the final product was commercially a different one from the ingredients or the raw materials used. On going through the provisions of Section 10B of the Income Tax Act, there being no definition given to the word "manufacture", Explanation 4 to Section 10B

being added only under the Finance Act, 2003, the law as it existed relevant to the assessment year alone could be adopted; consequently, in the absence of any definition of the word "manufacture", the word has to be given a meaning as given in common parlance. Thus, applying the decision reported in *ASPINWALL and CO. LTD. Vs. Commissioner of Income Tax*, the Commissioner of Income Tax (Appeals) agreed with the assessee on the aspect of manufacture, to qualify for deduction u/s 10B of the Income Tax Act.

7. On the aspect of splitting up or re-construction of the business, the Commissioner of Income Tax (Appeals) held that the products dealt with by the assessee as well as by the company were totally different. The expenditure of the firm, even if were to be borne by the company and the employees of the company worked in the firm, such expenditure was to be a subject matter of disallowance at the hands of the company. Pointing out that there was no transfer of any assets by the company to the firm or the business of the company transferred to the firm, the question of holding that the firm was formed by splitting up or re-constructing the existing business could not be presumed. Thus the first Appellate Authority agreed with the assessee as to its entitlement for deduction u/s 10B of the Income Tax Act. As regards the allegation of the Assessing Officer that the same labour force worked in the company as well as in the firm, the Commissioner of Income Tax (Appeals) held that even if it be so, the inference on splitting up cannot be drawn without proper verification. In the light of the above, the claim of the assessee was allowed in toto. Aggrieved by this, the Revenue went on appeal before the Income Tax Appellate Tribunal.

8. The Tribunal dismissed the Revenue's appeal and confirmed the view of the Commissioner of Income Tax (Appeals). Referring to the decision reported in *ASPINWALL and CO. LTD. Vs. Commissioner of Income Tax*, the Tribunal held that in the absence of any definition, the word "manufacture" has to be understood in common parlance. When the commercially new product had come into existence after processing, the benefit of deduction u/s 10B of the Income Tax Act, on the manufacturing of item, necessarily applied to the case of the assessee on hand.

9. As regards the splitting up of the assessee company, the Tribunal agreed with the assessee and held that if the Assessing Officer had had any suspicion that the firm was formed by splitting up of the existing company, then, there must be sufficient evidence to substantiate such an allegation. Given the fact that the products manufactured by the company and the firm were totally different and the constitution of the firm was made out of capital contribution by partners from their personal funds, the conclusion drawn by the Assessing Officer was unfounded and this was not a case of splitting or reconstitution as would take the assessee out of the benefits of Section 10B of the Income Tax Act. Thus the Revenue's appeal was dismissed. Aggrieved by this, the present appeals have been preferred by the Revenue.

10. Learned standing counsel appearing for the Revenue pointed out that the

Tribunal failed to consider that the items exported were more of assembling the basic materials procured and in the absence of anything to show that there was manufacturing activity, the assessee could not be granted the relief. He supported the view of the Assessing Officer on the aspect of splitting up of the existing unit. Placing heavy reliance on the decision reported in Commissioner of Income Tax, Kerala Vs. Tara Agencies, , learned standing counsel submitted that mere lacquering or painting of the plants, by itself, would not result in manufacture. Consequently, the order of the Tribunal has to be set aside.

11. Countering the claim of the Revenue, learned counsel appearing for the assessee pointed out to the detailed process that the assessee had undertaken to result in a commercially new product to fit in with the export order and submitted that the dried flowers and plants component, which are raw materials, are not exported just by assembling. They should be bunched together and moulded in various shapes and form as per the desire of the foreign purchasers; further, the dried flowers and plant components are cleaned, graded, thereafterwards, according to the requirements, they are bleached, washed and coloured, lacquer is applied and after using necessary preservatives to maintain their shape, the products are perfumed and added glitter according to the design. Thus the end product is a totally different one from what was purchased as raw material. If the nature of activity involved was just cleaning and grading or sizing up and mere processing thereon, then the Revenue must prove the same to test the requirement of law on the issue of manufacture. However, given the fact that apart from cleaning and grading, the activity of the assessee has gone further to make the dried plants and leaves, fit for being called a potpourri or dried flowers for export, even as per the botanical name, the contention of the Revenue that there was no manufacturing activity cannot be accepted. Thus, even applying the subsequent amendments to the provisions u/s 2(29)BA or even as u/s 10B Explanation, the end product being different from what was originally purchased as raw material, the processing of the dried leaves or plants had gone to such an extent of irreversibility, the activity cannot be over-simplified to call it as a mere processing. In the circumstances, the reliance placed on the decision reported in Commissioner of Income Tax, Kerala Vs. Tara Agencies, would not be of any avail to the Revenue.

12. On the allegation of splitting up of the company into firm, he submitted that the business of the company as well as the firm were on two different lines. While the company deals with the low category products, the assessee firm deals with the premium product. There is absolutely no material on record for the Revenue to contend that there was splitting up of the company to firm. The mere existence of some of the partners in the company being the Directors of the firm, per se, would not lead to inference that there was a splitting up of a company to a partnership firm. In the circumstances, the Tribunal had correctly held that the assessee was entitled to the deduction u/s 10B of the Income Tax Act.

13. Heard learned standing counsel appearing for the appellant and the learned

senior counsel appearing for the respondent and perused the materials placed before this Court.

14. We agree with the contentions made by the learned senior counsel appearing for the assessee that the process which the assessee had undertaken satisfies the test of manufacture to qualify for relief u/s 10B of the Income Tax Act. As already narrated in the preceding paragraph, the emphasis of the Revenue is that in the absence of any definition under the Act as to what "manufacture" is, the decision of the Apex Court reported in *Commissioner of Income Tax, Kerala Vs. Tara Agencies*, would squarely apply. It is contended that every change is not "manufacture" and every change in an article as the result of treatment, per se, would not result in "manufacture". There is no dispute on this broad principle. However, it is not denied by the Revenue that apart from cleaning and grading, the assessee had taken further processing; that what is purchased as raw material and what is exported as a product for export are totally different items. The process that the assessee had undertaken clearly points out the irreversible nature of the final end product from a raw material purchased and given the above said fact, which the Revenue does not deny, we have no hesitation in accepting the contention of the assessee that there was, in fact, "manufacture".

15. We accept the contention of the assessee in this regard drawing support from the decision of the Apex Court reported in *ASPINWALL and CO. LTD. Vs. Commissioner of Income Tax*, that the word "manufacture" has to be understood in common parlance, there being no definition of the word "manufacture" in the Act. Even if one looks at the definition of "manufacture", as given under Explanation 3 to Section 10B, as it existed prior to its substitution in 2001, we find, the term was defined inclusively that any process or assembling or recording of programme or disc, tape, perforated media or other information storage device are brought under the definition of "manufacture". In any event, with the definition of "manufacture" available as under Explanation 4 to Section 10B of the Income Tax Act, inserted by Finance Act, 2003, with effect from 1.4.2004, which defines "manufacture or produce" to include the cutting and polishing of precious and semi-precious stones, as is relevant for the assessment years under consideration, the decision relied on by the Revenue is not of any assistance. Learned Standing counsel appearing for the Revenue brought to our attention Section 2(29)BA, inserted under the Finance (No. 2) Act 2009, with effect from 1.4.2009, which defines "manufacture" to mean a change in a non-living physical object or 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 and use; or bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure.

16. Even though the definition of "manufacture" u/s 2(29)BA, as amended under Finance Act 2 of 2009, with effect from 1.4.2009 and Explanation 3 to Section 10B, as it stood prior to the Finance Act, 2001 are not of any relevance to the

case on hand relating to the assessment years 2004-05, 2005-06, 2006-07 and 2008-09, yet, with Explanation 4 to Section 10B of the Income Tax Act, inserted by Finance Act, 2003 with effect from 1.4.2004, defining "manufacture" or produce" to include the cutting and polishing of precious and semi-precious stones and the idea of granting exemption/deduction u/s 10B being clear, the relief u/s 10B of the Income Tax Act cannot be denied.

17. In the decision reported in *ASPINWALL and CO. LTD. Vs. Commissioner of Income Tax*, , the Apex Court observed "the word "manufacture" has not been defined in the Income Tax Act. In the absence of a definition, the word "manufacture" has to be given a meaning as is understood in common parlance. It is 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 article results in a new and different article then it would amount to manufacturing activity." Thus the Apex Court pointed out that if the commodity can no longer be regarded as the original commodity but instead is recognized as a new and distinct article, then the activity of manufacture can be said to take place.

18. The decision relied on by the Revenue reported in *Commissioner of Income Tax, Kerala Vs. Tara Agencies*, , however, stands on a different footing. There, the assessee was engaged in purchase of different qualities of tea and blending the same for the purpose of export. On the question as to whether the assessee would be entitled to weighted deduction u/s 35B(1A) of the Income Tax act, the Supreme Court pointed out on facts that the assessee's activity amounted to processing only and the activity did not amount to production or manufacture. Thus the case relied on by the Revenue is distinguishable on facts.

19. Given the admitted fact that what was purchased by the assessee as raw material and exported goods are totally different items and commercially known as a different product, going by the definition "manufacture" in Explanation 4 to Section 10B of the Income Tax Act, we have no hesitation in agreeing with the contention of the assessee and thereby confirm the order of the Tribunal.

20. As regards the splitting up u/s 10B(2)(ii) of the Income Tax Act, it is not denied by the Revenue that the assessee firm is a different assessable entity from the company. It is not denied by the Revenue that the mere fact of both the entities carrying on the same business, per se, would not lead to a conclusion that there was a splitting up of a company to a new entity, namely, firm. The Commissioner of Income Tax (Appeals) as well as the Tribunal had looked into the facts of the case and ultimately came to the conclusion that the mere presence of three of the Directors as partners, by itself, would not make the firm as one, split up from the company and both the entities deal in different graded products and they were one and the same while the company dealt with low end products, the assessee deals with high end products. The Tribunal, as a final fact finding authority, has also pointed out that the firm was constituted with the capital contribution by the partners from their personal funds. Thus, we do not

find neither the presence of the partners nor the products dealt with would be of any guidance to decide the issue raised by the assessee. So too the workmen working in the assessee's business and in the company. In the absence of any material to substantiate the contention of the Revenue that the firm was constituted by splitting up of the company, we have no hesitation in rejecting the plea of the Revenue. Consequently, we have no hesitation in confirming the order of the Tribunal. For the reasons we have already given in the preceding paragraph, the above Tax Case (Appeals) are dismissed. No costs.