
(2014) 04 MAD CK 0131

In the Madras High Court

Case No : Tax Case (Appeal) Nos. 207 and 208 of 2008

Super Auto Forge Ltd.

APPELLANT

Vs

Additional Commissioner of Income Tax, Chennai

RESPONDENT

Date of Decision : 15-04-2014

Acts Referred:

Income Tax Act, 1961 — Section 10(A)(2)(iii), 10A, 10A(2), 10A(2) (iii), 10A(2)(iii)
Industries (Development and Regulation) Act, 1951 — Section 14

Citation : (2014) 365 ITR 318

Hon'ble Judges : T.S. Sivagnanam, J;Chitra Venkataraman, J

Bench : Division Bench

Judgement

Chitra Venkataraman, J.—The assessee has preferred the above Tax Case (Appeals) as against the common order of the Income Tax Appellate Tribunal relating to the assessment year 2001-02.

2. The assessee is engaged in the business of manufacturing auto parts, particularly cold forged auto components. The assessee has four units, situated at Ekkaduthangal, Medavakkam, Kolapakkam and Thirumudivakkam. For the assessment year 2001-02, the assessee showed a net profit of Rs. 14,63,54,338/- and claimed exemption u/s 10B of the Income Tax Act at Rs. 11,16,23,811/- in respect of its 100% Export Oriented Unit (EOU), situated at Thirumudivakkam.

3. The assessment was taken up for scrutiny and accordingly, notice u/s 143(2) of the Income Tax Act was served on the assessee on 31.10.2002. A survey u/s 133A of the Income Tax Act was conducted in the EOU unit, situated at Thirumudivakkam on 14.11.2003 to verify the claim of exemption u/s 10B of the Income Tax Act. During the course of survey, statement was recorded from the General Manager (Operations) and subsequently, the Managing Director of the company was enquired and his statement was also recorded. On an analysis of the facts the Assessing Officer held that the land at Thirumudivakkam was purchased in the year 1999 from SIDCO and the construction of the factory

building therein was commenced during June, 1999 and completed during March, 2000. The unit was first registered as Domestic Tariff Area Unit (DTA) with the Central Excise Authorities on 03.11.1999. The activities like building construction, plant erection, machinery erection, commissioning and testing of machinery etc. were carried out in the DTA unit prior to its conversion into EOU in March, 2000. An application dated 11.3.2000 was submitted by the company before the Madras Export Processing Zone (MEPZ) to treat the DTA Unit as 100% EOU unit. The list of machinery already installed in DTA before its conversion into EOU Unit was mentioned in the application. These machinery were stated to have been transferred from other units to the Thirumudivakkam unit. It is stated that the machinery installed in the said unit, at the time of making application for EOU status as on 11.3.2000, was sufficient to carry on the manufacturing process and the unit was ready to commence production by third week of March, 2000. MEPZ issued the Green Card on 27.3.2000 for the manufacture and export of Cold Forged Heat Treated Machined Components and ultimately the EOU status was granted on 31.3.2000. Thus the unit came into existence from 31.3.2000 as EOU unit.

4. It is seen from the narration of facts in the order of the Assessing Officer that the value of the new machinery installed at Thirumudivakkam unit as on 31.3.2000 was Rs. 3,33,78,440/-. For the period 1.4.2000 to 31.3.2001, there was further addition of new machinery to the tune of Rs. 1,37,17,032/-. The Assessing Officer viewed that going by Clause (iii) to sub-section (2) of Section 10B of the Income Tax Act, the value of the old machinery transferred ought not to have exceeded 20% of the total value of the machinery. Even though the unit at Thirumudivakkam was ready to commence production by third week of March, 2000 itself, the value of the transferred machinery being more than 20%, the assessee failed the test of eligibility as prescribed u/s 10B(2) of the Income Tax Act. It was further pointed out that since the EOU at Thirumudivakkam was formed by 31.3.2000, the subsequent addition of machinery from 1.4.2000 to 31.3.2001 amounting to Rs. 1,37,17,032/- could not be included in the computation of the value of the total machinery; consequently, the assessee was not entitled to any relief u/s 10B of the Income Tax Act for the assessment year 2001-2002. The Assessing Officer further pointed out that in finding out the percentage of value of the transferred machinery, factory building could not be considered as plant and machinery and that they had to be classified as building only. The Officer further pointed out that the assessee had not classified the building as part of plant and machinery at the time of filing its return of income and it claimed depreciation at the normal rate of 10%. Only for the purpose of claiming deduction u/s 10B, the assessee had classified the building as plant and machinery; thus, it was clearly an after thought. Considering the value of the machinery transferred, which was more than 20%, the claim of the assessee had to fail.

5. The Assessing Officer referred to the decision reported in Commissioner of Income Tax, Trivandrum Vs. M/s. Anand Theatres, and held that the distinction

between "plant and machinery" or "building" could not be lost sight of; consequently, the assessee's plea for treating the building as "plant" was unsustainable in law. The Officer further pointed out that the assessee itself had valued the transferred machinery to a sum of Rs. 2,26,99,000/-. Thus, read in the context of the statement recorded from the officials of the company and the value of the transferred assets, the assessee was not entitled to the relief u/s 10B of the Income Tax Act. The Officer pointed out that the even allowing for a margin of 10% difference in the valuation of the assets, the percentage of the old machinery would come to 38% of the total machinery and hence the assessee was ineligible to claim exemption u/s 10B of the Income Tax Act. Aggrieved by this, the assessee went on appeal before the Commissioner of Income Tax (Appeals).

6. The Commissioner of Income Tax (Appeals) pointed out that the assessee itself had conceded that the value of the plant and machinery previously used and transferred to new unit exceeded 20% at the time of commencement of production in April, 2000. It had not fulfilled the conditions laid down u/s 10B(2) (iii) of the Income Tax Act, hence ineligible to claim exemption from 1.4.2000 onwards. However, the Commissioner of Income Tax (Appeals) pointed out that from the date of acquisition of plant and machinery in the year 2001-02, the value of the old machinery fell below 20% of the total value of the plant and machinery. Thus, after analysing the value of the old plant and machinery and the investment in the new machinery, the Commissioner of Income Tax (Appeals) came to the conclusion that by using the method of valuation by the Registered valuer as on 1.8.2000, the percentage of the value of the old machinery would be less than 20% and accordingly, the assessee would be entitled to exemption u/s 10B of the Income Tax Act from 1.8.2000 to 31.3.2001 and the assessee would also be entitled for deduction u/s 80HHC of the Income Tax Act in respect of "profits of business" from exports for the period upto 31.7.2000. Aggrieved by the restricted relief u/s 10B from 1.8.2000 to 31.3.2001, the assessee preferred an appeal before the Income Tax Appellate Tribunal and the Revenue, on its part, preferred an appeal as against the grant of relief to the assessee from 1.8.2000 to 31.3.2001.

7. On a reading of the provisions u/s 10B(2), the Tribunal pointed out that the benefit under the said Section would not be available to an undertaking, if the said undertaking is formed by transfer to a new business, any plant and machinery previously used for any purpose and going by the Explanation therein. Further, if the value of the machinery transferred exceeds 20% of the total value of the machinery or plant used in the business, the assessee would not be entitled to any relief. The Tribunal pointed out that going by the facts as stated in the order of the Commissioner of Income Tax (Appeals) and in the order of the Assessing Officer, it was clear that the assessee had conceded that the value of the plant and machinery previously used and transferred to new business exceeded 20% at the time of commencement of commercial production on 25.4.2000. The first batch of raw materials had arrived on 17.4.2000; thus,

2001-02 was the year of operation by the unit. The Tribunal further held that the assessee was recognised as EOU in April, 2000 when it commenced the production of article or thing. On the admitted fact that the assessee was using more than 20% of the plant and machinery, which were used earlier, on the total value of the machinery of the EOU unit, the assessee failed to comply with the plain condition mentioned u/s 10B; consequently, the assessee was not entitled to the relief. Thus the Tribunal upheld the contention of the Revenue that the assessee not being an eligible unit, the claim of Section 10B exemption was liable to be rejected.

8. As regards the assessee's contention that the Officer was not justified in not considering the factory building as part of plant and machinery, the Tribunal followed the decision reported in Commissioner of Income Tax, Trivandrum Vs. M/s. Anand Theatres, and held that the factory building could not be treated as plant and machinery for the purpose of finding out the limitation of 20% value on the transferred machinery, vis-?-vis, the total value of the machinery in the transferred unit.

9. Aggrieved by this, the assessee has filed the present Tax Case Appeals raising the following substantial questions of law:

T.C.(A) Nos. 207 & 208 of 2008:

Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal is right in law in holding that the appellant has not complied with sub-sec.(2) to sec. 10B of the Income Tax Act, 1961, for the whole of the assessment year 2001-02 and consequently not entitled to deduction of income u/s 10B of the Act?

T.C.(A) No. 207 of 2008:

Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal is right in law in holding that the structure of the industry constitutes building and is not eligible to be included in computing the plant and machinery for the purpose of determining the eligibility u/s 10B of the Act?

10. Learned senior counsel appearing for the assessee submitted that the Tribunal had committed a serious error in holding that the assessee had not satisfied the eligibility test to grant the claim of exemption u/s 10B of Income Tax Act. He pointed out that the unit in question was not the one which was set up as an 100% EOU but converted in status from DTA to EOU as per the laws relating to setting up of EOUs. When the Unit was set up as DTA, transfer of machinery was permitted by law and subsequently it got converted in status by virtue of the trade policy of the Government. Thus, he submitted that the Tribunal committed serious error in taking a narrow view as regards the scope of Section 10B(2)(iii) of the Income Tax Act. He further pointed out that the Tribunal committed an error in taking a narrow view that any addition to the plant and machinery within three months after commencement of production in April, 2000 would not help

the assessee in claiming exemption. Apart from this, the assessee had also raised questions on the valuation aspect of machinery.

11. Learned senior counsel further pointed out that the assessee has four units and the Thirumudivakkam unit was ready to commence production by third week of March, 2000. Thus the unit had started constructing building and had gone for testing of the machinery too in the year 2000-2001 itself. The new machinery were installed in July, 2000. In the light of the fact that the assessee was originally approved as DTA unit and that the transfer had taken place even prior to the formation of EOU unit, the view of the Tribunal that the assessee had transferred the machinery of other units, thus exceeding the value of 20%, hence, ineligible to claim exemption, was totally contrary to the provisions of the Income Tax Act.

12. Learned Standing Counsel appearing for the Revenue supported the order of the Tribunal and submitted that when the admitted fact that the machinery transferred exceeded 20% of the total value of the machinery as on the date of formation of the EOU unit clearly shows the ineligibility as spelt out u/s 10B(2) of the Income Tax Act; hence, the case of the assessee has to be rejected.

13. Heard learned senior counsel appearing for the assessee and the learned standing counsel appearing for the Revenue and perused the materials placed before this Court.

14. We have gone through the order of the Tribunal as well as the order of the Authorities below. The admitted fact herein is that the assessee herein, originally treated as DTA unit, had made an application for conversion as EOU unit on 11.3.2000. Thus, on the date when the assessee was treated as DTA unit, it had its machinery transferred from other units. The activity relating to the construction of building and the installation of machinery was carried on during the period June, 1999 to March, 2000. The admitted fact herein is that the assessee as a DTA unit was registered with the Central Excise Authority on 03.11.1999 and the list provided by the assessee as regards the machinery installed therein showed that there were used machinery transferred from other units of the company to the Thirumudivakkam unit and the unit was ready to commence production by third week of March, 2000. The assessee was granted EOU status on 31.3.2000.

15. On the question as to whether by the grant of EOU status, there was formation of new business by a transfer, this Court considered the said issue in the decision reported in Commissioner of Income Tax Vs. Heartland Kg Information Ltd., . The issue arose as regards the grant of exemption u/s 10A of the Income Tax Act. The facts therein were that in 2001, KGISL, which enjoyed exemption u/s 10A of the Income Tax Act transferred its entire undertaking engaged in the export business of Medical Transcription along with all transcriptions contracts, books, records, all rights, all permits, all warranties, including computer software to the assessee company Heart Land KG

Information Limited by letter dated 28.5.2001 and 28.6.2001. The transfer was recognised and allowed by Software Technology Park of India. The transferee company claimed exemption u/s 10B of the Income Tax Act. The Assessing Officer rejected the claim that the assessee had not satisfied the conditions on account of transfer of business. On appeal, the claim of the assessee was allowed by the Tribunal. On appeal to the High Court, the question arose as to whether the assessee was entitled to the relief that it did not satisfy the provisions of Section 10A(2)(iii) of the Income Tax Act.

16. Referring to Section 10A(2) (iii), which is similar to Section 10B(2)(iii), this Court pointed out that what is prohibited in Section 10A(2)(iii) is the transfer of used machinery and plant to a new business undertaking and forming of an industrial undertaking by splitting or reconstruction of the existing industrial undertaking. There was no specific prohibition either express or inference to an industrial unit formed by transfer of entire business. This Court pointed out that the transfer was not that of plant and machinery alone but of sale of whole business unit to the transferee company which was only of export of articles or things. In this regard, this Court referred to the decision reported in The Commissioner of Income Tax, City-VII, Mumbai Vs. M/s. Sonata Software Ltd., , which in turn referred to the decision of the Supreme Court reported in [1997] 107 ITR 195 (Textile Machinery Corporation Limited v. CIT, wherein, it was held that where a running business was transferred lock, stock and barrel by one assessee to another assessee, the principle of reconstruction, splitting up and transfer of plant and machinery could not be applied. This Court further pointed out that there could be no denial of exemption on the conversion of the proprietorship business into the partnership to result in the disentitlement of the benefit u/s 10A of the Income Tax Act. On a reading of Section 10A(2), particularly clause (iii), this Court held that an undertaking would be disentitled to claim exemption, if it is formed by splitting up or re-construction of business already in existence.

17. We find Section 10B(2) is no different from Section 10A(2). The Explanation in Section 10A(2) referred to the provisions of Explanation 1 and 2 to sub-section (2) of Section 80I as applicable for the purpose of Clause (iii). Clause (iii) to Section 10A(2) and Clause (iii) to Section 10B(2) with explanation reads as under:

Special provision in respect of newly established undertakings in free trade zone, etc.

10A (1) ...

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

(i)...

(ii)...

(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 sub-section (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.

Special provisions in respect of newly established hundred per cent export-oriented undertakings

10B (1)...

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

(i)...

(ii)...

(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 sub-section (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.

18. Explanation (2) to sub-section (2) of Section 80I of the Income Tax Act, with which we are concerned, reads as under:

Deduction in respect of profits and gains from industrial undertakings after a certain date, etc.

80-I. (1) ...

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

...

Explanation 2. Where in the case of an industrial undertaking, any machinery or plant or any part thereof previously used for any purpose is transferred to a new business and the total value of the machinery or plant or part so transferred does not exceed twenty per cent of the total value of the machinery or plant used in the business, then, for the purposes of clause (ii) of this sub-section, the condition specified therein shall be deemed to have been complied with.

19. Thus, applying the decision reported in Commissioner of Income Tax Vs. Heartland Kg Information Ltd., to Section 10B(2)(iii), we hold that to attract Section 10B favourably to an undertaking, such undertaking should not be formed by transfer to a new business any machinery or plant previously used for any purpose. Applying Explanation (2) to sub-section (2) of Section 80I of the Income Tax Act, we find that even if there be transfer of machinery previously

used for any purpose is transferred, the total value of the machinery at plant so transferred should not exceed 20% of the total value of the machinery used in the business.

20. In the context of such restriction seen in the provision, the question that arises for consideration herein is as to whether the assessee, which was originally a DTA unit, later on converted as 100% EOU, would be hit by clause (iii) to sub-section (2) of Section 10B of the Income Tax Act.

21. Going by the reasoning given under the decision reported in Commissioner of Income Tax Vs. Heartland Kg Information Ltd., , we hold that when a DTA unit is converted into 100% EOU unit, there is neither a transfer nor a creation of a new business to attract Clause (iii) to sub-section (2) of Section 10B of the Income Tax Act. As pointed out by this Court in the reported decision, there is no specific prohibition to an industrial unit formed by transfer of entire business and more so, on the facts of the case herein, strictly speaking, there is no transfer at all to a new business and what was already in existence as a DTA unit, by reason of the recognition granted by the statutory authority, it became a 100% EOU unit. Thus the status granted to a DTA unit as a 100% EOU unit does not result in a transfer or splitting up or re-construction of a business already in existence so as to fall under Clause (iii) of sub-section (2) of Section 10B of the Income Tax Act.

22. In fact, the Board itself has clarified the position in the circular issued by it in Circular No. 1 of 2005 dated 06.01.2005. The Department of Revenue (Central Board of Direct Taxes) clarified the question as to whether an undertaking set up in Domestic Tariff Area, which is subsequently approved as 100% EOU by the Board appointed by the Central Government in exercise of powers conferred u/s 14 of the Industries (Development and Regulation) Act, 1951, is eligible for deduction u/s 10B of the income tax Act. On the representation received from various quarters, the Board clarified as follows:

4. The matter has been examined and it is hereby clarified that an undertaking set up in Domestic Tariff Area (DTA) and deriving profit from export of articles or things or computer software manufactured or produced by it, which is subsequently converted into a EOU, shall be eligible for deduction u/s. 10B of the IT Act, on getting approval as 100% export oriented undertaking. In such a case, the deduction shall be available only from the year in which it has got the approval as 100% EOU and shall be available only for the remaining 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 a DTA unit. Further, in the year of approval, the deduction shall be restricted to the profits derived from exports, from and after the date of approval of the DTA unit as 100% EOU. Moreover, the deduction to such units in any case will not be available after assessment year 2009-10.

23. In the light of the view that we have taken, the questions, as admitted, merit

to be re-framed as follows:

1. Whether, on the facts and circumstances of the case, the Income Tax Appellate Tribunal is right in law in holding that the assessee was not entitled to exemption u/s 10B of the Income Tax Act, particularly when the assessee, originally a DTA unit was converted as 100% EOU unit?

2. Whether, on the facts and circumstances of the case, that such recognition given to a DTA unit as 100% EOU unit, provisions of Section 10B(2)(iii) of the Income Tax Act are attracted to determine the eligibility u/s 10B of the Income Tax Act?

24. Thus going by the circular clarifying the stand that the DTA unit on conversion to 100% EOU unit eligible for exemption u/s 10B of the Income Tax Act also, we have no hesitation in rejecting the plea of the Revenue. In the circumstances, we have no hesitation in setting aside the order of the Tribunal to allow the Tax Case (Appeals). Accordingly, both the above Tax Case (Appeals) are allowed and the order of the Income Tax Appellate Tribunal is set aside. No costs.