

IN THE HIGH COURT OF BOMBAY AT GOA
TAX APPEALS NO.13 &14 of 2013 & 25 OF 2014

WITH

STAMP NUMBER APPLICATION NO. 3436 & 3428 OF 2013

The Commissioner of Income Tax,

Aayakar Bhavan, Patto, Panaji, Goa.

.... Appellant

Versus

M/s. Sesa Goa Ltd.,

Sesa Ghor, 20 EDC Complex,

Patto Plaza,

Panaji-Goa, 403 001.

PAN : AACCS7101B

.... Respondent

Ms. Susan Linhares, Standing Counsel for the Appellant.

Mr. P. Pardiwala, Senior Advocate with Mr. P. Kakodkar, Advocate for the Respondent.

**Coram: - M.S. SONAK &
DAMA SESHADRI NAIDU, JJ.**

Reserved on : 26 OCTOBER 2020

Pronounced on : 7 MAY 2021

JUDGMENT: (*Per Dama Seshadri Naidu, J.*)

Facts:

Respondent-Assessee Company mines and exports iron ore, besides dealing in shipping and shipbuilding, manufacturing and selling low-ash metallurgical coke. In September 2009, it filed its return declaring a total

income of ₹2007,48,80,920/-. The appellate Department processed the return of income under section 143 (1) and took the case up for scrutiny. First, ACIT, Circle-I, Panaji, notified the assessee under section 143 (2) of Income Tax Act. Later, the case was assigned to the Joint Commissioner of Income Tax, Range-1, Panaji, who issued a notice under section 129 of the Act in August 2011. In response to the notices, the assessee furnished information and produced the relevant documents.

2. Eventually, on 30.12.2011, the Assessment Officer did the following:

- (a) Disallowed expenditure of ₹12,29,25,049/- under section 14A of the IT Act, read with Rule 8D of IT Rules;
- (b) Declared that the assessee was ineligible for deduction of expenditure incurred on 'Scientific Research and Developments' (R&D) under section 37 of Act. So, the AO disallowed the expenditure of ₹1,94,55,376/- and added it back to the profit and loss account;
- (c) Following the pattern of assessment for AY 2006-07 regarding the same assessee, the AO disallowed the commission payment. As a result, ₹9,88,29,729/- was added back to the total income;
- (d) ₹1,55,76,549/- was added back to the total income. It was on account of demurrages the assessee paid to a shipping company in Pakistan;
- (e) The assessee claimed as expenditure education cess and fringe benefit tax, totalling to ₹19,72,00,814/-. But that was disallowed.
- (f) The assessee claimed deductions under section 10B of the Act for its three EOUs, totalling to ₹4,51,27,84,122/-. But the AO disallowed the benefits claimed by the assessee for all the three units.

(g) The foreign remittances of ₹57,80,379/- (sale proceeds) relating to 100% EOU of Assessee's Amona Division was not received within the time limit specified under section 10B of the Act. So, the AO disallowed the deduction of that amount, too.

(h) The assessee showed notional loss of ₹9.08 crores on foreign exchange transactions. The AO treated that loss from forward contracts as speculation loss and, accordingly, disallowed that loss of ₹1,59,00,000/-.

(i) The assessee claimed additional depreciation on metallurgical coke division, totalling to ₹10,91,79,435/- on purchase of new plant and machinery during the year. That was disallowed.

(j) The AO also disallowed ₹61,35,482/-, the expenditure the assessee incurred to increase the authorised share capital.

(k) The AO also initiated penalty proceeding under section 271(1)(c) of the Act for furnishing inaccurate particulars of income.

3. Aggrieved, the assessee appealed to the Commissioner of Income Tax (Appeals), Panaji. The Ld. CIT(Appeals), through Order, dated 31/08/2012, allowed the appeal in part :

- (a) Confirmed the disallowance under section 14A of the Act;
- (b) Deleted the addition of expenditure on disallowance of expenditure on R & D.
- (c) Confirmed the disallowance of commission paid to non-resident agents.
- (d) Confirmed the disallowance of demurrage payment u/s. 40(a)(i) of the Act.
- (e) Confirmed the disallowance of education cess.

(f) Confirmed disallowance of deductions u/s.10B regarding the three EOUs. (g) Deleted the additions made because of the losses in foreign exchange transactions.

(h) Confirmed the disallowance of additional depreciation.

(i) Deleted the expenditure incurred in respect of bonus shares.

Sl. No.	Assessment Order	CIT (Appeals) Order
(a)	Disallowed expenditure of ₹12,29,25,049/- under section 14A of the IT Act, read with Rule 8D of IT Rules;	Confirmed the disallowance under section 14A of the Act;
(b)	Declared that the assessee was ineligible for deduction of expenditure incurred on 'Scientific Research and Developments' (R&D) under section 37 of Act. So, the AO disallowed the expenditure of ₹1,94,55,376/- and added it back to the profit and loss account;	Deleted the addition of expenditure on disallowance of expenditure on R & D.
(c)	Following the pattern of assessment for AY 2006-07 regarding the same assessee, the AO disallowed the commission payment. As a result, ₹9,88,29,729/- was added back to the total income;	Confirmed the disallowance of commission paid to non-resident agents.
(d)	₹1,55,76,549/- was added back to the total income. It was because of demurrages the assessee paid to a shipping company in Pakistan;	Confirmed the disallowance of demurrage payment u/s. 40(a)(i) of the Act

(e)	The assessee claimed as expenditure education cess and fringe benefit tax, totaling to ₹19,72,00,814/-. But that was disallowed.	Confirmed the disallowance of education cess.
(f)	The assessee claimed deductions under section 10B of the Act for its three EOUs, totalling to ₹4,51,27,84,122/-. But the AO disallowed the benefits claimed by the assessee for all the three units.	Confirmed disallowance of deductions u/s.10B regarding the three EOUs.
(g)	The foreign remittances of ₹57,80,379/- (sale proceeds) relating to 100% EOU of Assessee's Amona Division was not received within the time limit specified under section 10B of the Act. So, the AO disallowed the deduction of that amount, too.	Confirmed disallowance of deductions u/s.10B regarding the three EOUs.
(h)	The assessee showed notional loss of ₹9.08 crores on foreign exchange transactions. The AO treated that loss from forward contracts as speculation loss and, accordingly, disallowed that loss of ₹1,59,00,000/-.	Deleted the additions made because of the losses in foreign exchange transactions.
(i)	The assessee claimed additional depreciation on metallurgical coke division, totalling to ₹10,91,79,435/- on purchase of new plant and machinery during the year. That was disallowed.	Confirmed the disallowance of additional depreciation.
(j)	The AO also disallowed ₹61,35,482/-, the expenditure the assessee incurred to	Deleted the expenditure incurred

	increase the authorised share capital.	in respect of bonus shares.
(k)	The AO also initiated penalty proceeding under section 271(l)(c) of the Act for furnishing inaccurate particulars of income.	

4. Then, both the Assessee and the Revenue filed appeals before the Income Tax Appellate Tribunal, Panaji Bench, Goa. The learned Tribunal took up the appeals together and disposed them of by a common order, dated 08/03/2012 :

- (a) Reversed the disallowance under section 14A of the Act.
- (b) Confirmed the CIT (A)'s findings on the R&D expenditure in the Assessee's favour.
- (c) On the demurrage charges, it ruled in Assessee's favour.
- (d) On the Assessee's claim for deduction under section 10B of the Act regarding the three 100% export-oriented units, it ruled in the Assessee's favour.
- (e) On the Assessee's claim for depreciation under section 32 (l) (iia) of the Act, the Tribunal ruled in the Assessee's favour.
- (f) It confirmed the CIT (A)'s finding in Assessee's favour on the issue of the losses in foreign exchange transactions.

5. Aggrieved, the Revenue has filed this Tax Appeal before this Court. While admitting the appeal, the Court framed these substantial questions of law:

- (I) Has the Tribunal correctly applied the definition of 'manufacture' given in SEZ Act 2005, which is applicable only for section 10AA of the IT Act and which imposes various conditions for the utilisation of profits?

(II) Has the Tribunal correctly directed the AO to restrict the open market right of the iron ore to average purchase value by applying section 10B (7) read with section 80 IA (8) of the IT Act though there are differences in grade/quality and though it was not at arm's length price?

(IIa) Is the Tribunal right in not considering *pro rata* overhead costs in determining profits from EVUs?

(III) Has the Tribunal correctly deleted the disallowance of ₹12.29 crore under section 14A of the IT Act in accordance with Rule 8D of IT Rules as held by the Mumbai Special Bench of the Tribunal in *ITO v. Daga Capital Management Pvt. Ltd.*?¹

Arguments:

Appellant-Revenue:

6. Ms. Linhares, the learned Standing Counsel for the Revenue, to begin with, has drawn our attention to the expression “manufacture” as defined in the SEZ Act, 2005. According to her, the ITAT (Tribunal) has erred in holding that processing itself amounts to "manufacturing" of iron ore; what has been manufactured must be a distinct commodity. To supplement her submissions on what amounts to manufacturing, Ms. Linhares also points out that the Assessee has not brought into existence a new and distinct object or article by using the processing plants (the EOUs). Besides, she asserts that the definition given in SEZ Act applies only to section 10AA of the IT Act. The Tribunal has also erred in interpreting section 2(29BA) widely and applying it to section 10B of the IT Act. For this proposition, she relies on the Supreme Court's decision in

¹(2009) 117 ITD 169

Chowgule & Co. Pvt. v. Union of India,² and this Court's decision in assessee's own case— *Commissioner of Income Tax vs. Sesa Goa Ltd.*³

7. Ms. Linhares has argued that a renovated unit cannot be treated as a new EOU, especially, when there were only additions or replacements to an existing unit. There is no cogent evidence, according to her, about the Assessee's dismantling the existing units.

8. On the second substantial question of law, Ms Linhares submits that the Tribunal has misapplied section 10B(7), read with section 80IA(8), of the IT Act. According to her, its direction to the AO to restrict the open market rate of the iron ore to average purchase value despite the differences in grade or quality cannot be sustained. Besides, she points that he ought to have considered the pro rata overhead costs in determining profits from the EOUs.

9. On the third substantial question of law, Ms. Linhares has drawn our attention to section 14A of the IT Act and Rule 8D of the IT Rules, besides the decision of Tribunal Mumbai Special Bench in *Daga Capital Management*.

10. To summarise, Ms. Linhares has submitted that (1) the Tribunal ought not to have been swayed by the definitional dynamics of section 10AA of the IT Act and section 2 (29) of IT Act; (2) it misunderstood the ratio of *Chowgule's* case; (3) blending of iron ore does not amount to manufacturing; (4) addition of machinery does not turn an old unit into a new one; and (5) the Tribunal has misapplied the concept of 'average purchase price'.

Respondent-Assessee:

²AIR 1981 SC 1014

³ITR 266 ITR 126

11. Shri Pardiwala has, to begin with, submitted that the Assessee's three Units are 100% EOUs; that aspect, according to him, has not been disputed. As a matter of fact, the Tribunal has ruled on how new Units have come into existence. Then, he has taken us to section 10B of the IT Act. Shri Pardiwala has explained how that section suffered an amendment and what applied to the Assessment Year in question.

12. To elaborate, Shri Pardiwala has submitted that the conversion of tailings or making crude run of iron ore into marketable end-product—that is, processing crude ore into lumps or fines—does amount to production or manufacture. According to him, Tribunal has neither misunderstood nor misinterpreted *Chowgule*. In other words, *Chowgule* deals with one facet of production, whereas the Assessee's processing of iron ore is much more elaborate, involving various other steps, too. So what the Assessee does in the three Units is more than mere processing; it is production, which is synonymous with manufacturing. Even the chemical combination, in that process, changes.

13. According to Shri Pardiwala, the Assessee's units do more than mere blending. The run of iron ore used as the raw material has no commercial application. On the other hand, the finished product—the lumps or fines—does have commercial value, for that has a different chemical composition. That is, what comes out is a new product. Then, the learned counsel has taken us through a few paragraphs of the Tribunal judgment, besides drawing our attention to certain precedents.

14. On the second substantial question of law, the learned counsel reckons that the Revenue has treated the Tribunal's remand as if it were partial. But it is a clean remand with a direction to the Assessing Officer to decide the issue as per the law. In the end, the learned counsel has

urged this court to dismiss all the appeals: TXA No. 13 of 2014, TXA No. 14 of 2014, and TXA No. 25 of 2014.

Discussion:

Substantial Question of Law No. 1:

(I) Has the Tribunal correctly applied the definition of ‘manufacture’ given in SEZ Act 2005, which is applicable only for section 10AA of the IT Act and which imposes various conditions for the utilisation of profits?

15. The Revenue, as we have noted, has argued that the definition given in SEZ Act applies only to section 10AA of the IT Act. The Tribunal has also erred in interpreting section 2(29BA) of the IT Act widely and applying it to the process under section 10B of the IT Act. So, let us examine the statutory scheme.

Statutory Scheme:

16. Section 10AA was introduced in the Act by the Special Economic Zones Act, 2005, with effect from 10 February 2006. The deduction under the section is available for fifteen consecutive assessment years: (i) for the first five years 100 per cent of profits and gains derived from the export of the goods, articles or services; (ii) for the next five years 50 per cent.; and (iii) for the last five years 50 per cent. Of course, it is subject to the creation of a special economic zone reinvestment reserve account. To that account, 50 per cent of profits is to be debited and utilized for the business.

17. The exemption is available to units commencing activity after April 1, 2006 but before April 1, 2021. Section 10AA stands, according to *Kanga & Palkivala*⁴, on an identical footing as section 10A, since the

⁴Kanga & Palkivala’s Law and Practice of Income Tax, Arvind P. Datar, 11 ed., e-book.

language of both sections is similar. Besides, they are both in Chapter III, so the principles laid down in judgments under s 10A would apply to this section as well. The renowned commentary also notes that the services must be provided, or articles or things must be manufactured from the SEZ unit. Where the core of the Assessee's services are provided from the unit, the assessee cannot be denied the benefit because some activities were performed outside of it.

18. Section 10B of the Act is a special provision concerning newly established 100% export-oriented undertakings. This section grants a deduction of the profits and gains derived by a hundred per cent. export oriented undertaking (EOU) from the export of articles or things or computer software. The nature of this deduction is very similar to that under section 10A. The deduction is granted for ten years from the assessment year relevant to the previous year in which the undertaking begins manufacture of articles or things or computer software. The approval granted by the Board of Approval as a hundred per cent. It earlier granted a tax holiday for five consecutive years for hundred per cent. export oriented undertakings. By the Income-tax (Second Amendment) Act, 1998, the tax benefit or tax holiday was extended for ten consecutive assessment year[₹] Of course, the entire section was recast by the Finance Act, 2000, with effect from April 1, 2001, when s 10A was also recast in a similar manner. Thus, the two sections are substantially similar.

19. Factually, the dispute concerns the Assessee's claim of deduction under section 10B of the Act for its 100% export-oriented units at Amona in Goa, at Chitradurga in Karnataka, and at Codli in Goa. The AO has concluded that there was no production or manufacturing in the three units. To be explicit, the AO reasoned that Amona and Chitradurga units

commenced production in 1985 and 1994 respectively; they cannot be treated as new units eligible for the benefit under section 10B merely because these units were expanded with a new plant or machinery in 2002-03 and 2005-06 respectively.

20. Regarding the Unit at Codli, the AO reasoned that it does not fulfill the conditions of manufacture or production as required under section 10B (b) of the Act. Nor has the Assessee produced any satisfactory evidence about the date of commencement of manufacturing or production. Of course, the AO has entered a finding regarding the alleged lack of fresh approval by the Board, too.

21. In a nutshell, the AO has held that (a) the iron ore processing cannot be treated as "manufacturing" or production because of the new section 2 (29BA), defining "manufacture/production"; (b) the assessee has not maintained separate books of accounts for the EOU units and for non-EOU units; the old units cannot be treated as new ones merely because a plant or some machinery has been added. Indeed, the CIT (A) has confirmed these findings. Then, the Tribunal has reversed these findings.

(a) Do the Assessee's Units manufacture or produce any product?

22. Chitradurga Beneficiation Plant processes crude iron ore (Run of Mines or ROM) extracted from the mines. As a part of the process, the oversized crude iron ore lumps are crushed and are subjected to further processing. What finally emerges is iron ore lumps and fines. Different sizes of lumps having different chemical and physical compositions are mixed mechanically as per the product composition ordered by the overseas buyers.

23. Processes undertaken at Codli Ultra Fine Recovery (UFR) Plant the waste called 'tailings' generated at the iron ore beneficiation plant is further processed and low-grade iron ore is produced. Eventually, The

dewatered "Ultra Fines", which is the final product, is exported. And, as a matter of record, all the Units gained approval as EOUs from the Development Commissioner.

24. As to the Unit at Amona, the question was whether it is a new Unit. In paragraph 42.2 of the judgment, the Tribunal has recorded its findings on facts. It accepted the Assessee's application for a personal visit to the Unit, and its Members, along with the IT officials, did visit the Unit. It was to "understand the type of plant & machinery installed at the iron ore Beneficiation plant and also the processes undertaken for production".

25. In the end, the Tribunal has recorded the finding that the nature of activities at Amona plant and Chitradurga plant are similar. Both these units as well as Codli plant are approved as 100% EOU units, for the Assessee has placed on record the necessary Board approvals. For Codli Unit, the approval was given initially for five years; it was subsequently extended.

26. Then, the Tribunal has addressed the issue whether all these units are manufacturing or producing any article or thing. Let us examine the respective spheres of sections 10A, 10AA, and 10B of the IT Act. Section 10A is a special provision dealing with the newly established undertakings in free-trade zone, and so on; section 10AA deals with the newly established units in special economic zones; section 10B deals with the newly established 100% EOUs.

27. Section 10B provides that any profits and gains derived by an assessee from a 100% EOU shall not be included in the assessee's total income. This provision applies to any undertaking manufacturing or producing any article or thing. Explanation (i) to section 10B clarifies that the expression "100% Export Oriented Unit" means an undertaking

approved by the Board appointed in this behalf by the Central Government in exercise of the powers confirmed by section 14 of the Industries (Development and Regulation) Act, 1951, and the Rules made under that Act.

28. The initial Explanation (iii), which was later removed, defined the word “manufacture” and treated these activities as manufacture: (a) process; (b) assembling; (c) recording of programme on disc, tape, perforated media or other information storage device. Explanation (iv) of section 10B further elaborated on the meaning of “produce”.

29. True, this definition of “manufacture” was removed when sections 10A and 10B of the Act were amended by the Finance Act, 2001. These two provisions suffered a further amendment through the Finance Act, 2003. Explanation (iv) is merely inclusive as it declares that “manufacture or produce” shall include the cutting and polishing of precious and semi-precious stones. On the other hand, clause (iii) of Explanation to section 10AA adopts the definition of “manufacture” clause (r) of section 2 of the SEZ Act, 2005.

30. As defined under clause (r) of section 2 of the SEZ Act, “manufacture” means “to make, produce, fabricate, assemble, process or bring into existence, by hand or by machine, a new product having a distinctive name, character or use and shall include processes such as refrigeration, cutting, polishing, blending, repair, remaking, re-engineering and includes agriculture, aquaculture, animal husbandry, floriculture, horticulture, pisciculture, poultry, sericulture, viticulture and mining”. This definition is both exhaustive (“means”) and inclusive (“shall include”), too. The inclusive part is merely clarificatory, though.

31. Later, through the Finance Act, 2009, clause (29BA) was inserted in section 2 of the IT Act, defining the expression “manufacture”:

“manufacture”, with its grammatical variations, means a change in a non-living physical object or article or thing,— (a) 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 (b) bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure.

32. The Tribunal has heavily relied on *Chowgule*. But the Revenue insists that the Tribunal has misread and misapplied *Chowgule’s* case holding to these appeals. First, this decision was under the Central Sales Tax Act, 1956; second, “manufacturing” was in the context of the definitional dynamics of that Act, not that of the IT Act.

33. In *Chowgule*, the appellant mines iron ore and blends diverse quantities of ore. These diverse quantities possess different chemical and physical compositions. This blending results in the production of ore of the requisite chemical and physical composition demanded by the foreign purchaser. When the appellant purchased certain items, they wanted lesser sales tax applied because those items of goods were purchased for the use in producing exportable commodity.

34. In the above context, the Supreme Court has examined whether the appellant, in the first place, involves itself in any manufacturing or processing. Section 13 of CST Act allows the Central Government to enumerate goods or class of goods used in “the manufacture or processing of goods for sale or in mining or in the generation or distribution of electricity or any other form of power”. Rule 13 mandates that the goods a registered dealer may purchase shall be goods intended for use by him as raw materials, processing materials, machinery, plant, equipment, tools, stores, spare parts, accessories, fuel, or lubricants, “in the manufacture or processing of goods for sales or mining, or in the generation or

distribution of electricity or any other form of power”. After referring to the ratio of *Deputy Commissioner of Sales Tax v. Pio Food Packers*,⁵ *Chowgule* has answered this question: does the processing of the original commodity bring into existence a commercially different and distinct commodity?

35. Answering the above question, *Chowgule* has held that the blending of different qualities of ore possessing different chemical and physical compositions so as to produce ore of the contractual specifications cannot be said to involve the process of manufacture, since the ore that is produced cannot be regarded as a commercially new and distinct commodity from the ore of different specifications blended together. What is produced because of blending is commercially the same article, namely, ore, though with different specifications than the ore blended and hence it cannot be said that any process of manufacture is involved in blending of ore. That said, *Chowgule* has posed unto itself another question: Does the ore blending in the course of loading through the mechanical ore handling plant amount to processing? The answer to this question, according to *Chowgule*, depends on what “the true meaning and connotation” of the word ‘processing’ is. It holds:

“[T]his word has not been defined in the Act and it must therefore be interpreted according to its plain natural meaning. Webster's Dictionary gives the following meaning of the word “process”: “to subject to some special process or treatment; to subject (especially raw material) to a process of manufacture, development of preparation for the market etc.; to convert into marketable form as livestock by slaughtering, grain by milling, cotton by spinning, milk by pasteurizing fruits and vegetables by sorting and repacking.” Where therefore any commodity is subjected to a process or treatment with a view to its “development or preparation for the market”, as, for example, by sorting and repacking fruits and vegetables, it would amount to processing of the commodity within the meaning of Section 8(3)(b) and Rule 13. The nature and extent of processing may vary from case to case; in one case the processing may be slight and in another it may be extensive; but with each process suffered,

the commodity would experience a change. Wherever a commodity undergoes a change as a result of some operation performed on it or in regard to it, such operation would amount to processing of the commodity. The nature and extent of the change is not material. It may be that camphor powder may just be compressed into camphor cubes by application of mechanical force or pressure without addition or admixture of any other material and yet the operation may [Corrected vide letter No. F.3/79 (Ed. J), dated January 30, 1981] amount to processing of camphor powder as held by the Calcutta High Court in *Om Prakash Gupta v. Commissioner of Commercial Taxes* [16 STC 935 (Cal HC)] . What is necessary in order to characterise an operation as “processing” is that the commodity must, as a result of the operation, experience some change”.

36. On facts, *Chowgule* has held that diverse quantities of ore possessing different chemical and physical compositions are blended to produce ore of the requisite chemical and physical composition demanded by the foreign purchaser. And obviously, as a result of this blending, the quantities of ore mixed in the course of loading through the mechanical ore handling plant experience change in their respective chemical and physical compositions. Thus, what is produced by such blending is ore of a different chemical and physical composition. In other words, when the chemical and physical composition of each kind of ore which goes into the blending is changed, “there can be no doubt that the operation of blending would amount to ‘processing’ of ore.

37. After relying on *Chowgule*, the Tribunal has concluded that even blending of iron ore for export involves change in the chemical and physical composition of iron ore. It has, then, gone one step ahead and observed that the Assessee is not only blending iron ore but also carrying out various processes to make the crude ore usable. In this context, it has referred to clause (b) of section 2 (29BA) of the Act—that bringing into existence a new and distinct object or article or thing with a different chemical composition or integral structure is tantamount to ‘manufacture’.

38. We do accept that *Chowgule* was rendered in a different statutory backdrop. But under the CST Act, too, the term 'processing' has not been defined. Then, applying the common parlance meaning of 'processing' *Chowgule* ruled. In *Pio Food Packers*, as quoted by *Chowgule*, the Supreme Court has examined whether there is any manufacturing if the commodity 'subjected to the process of manufacture' can no longer be regarded as the original commodity but is recognised in the trade as a new and distinct commodity.

39. According to *Pio Food Packers*, commonly 'manufacture' is the end result of one or more processes through which the original commodity is made to pass. The nature and extent of processing may vary from one case to another. Indeed, there may be several stages of processing and, perhaps, a different processing at each stage. With each process suffered, the original commodity experiences a change. But it is only when the change, or a series of changes, takes the commodity to the point where commercially it can no longer be regarded as the original commodity but, instead, is recognised as a new and distinct article that a manufacture can be said to take place."

40. Does the processing of the original commodity bring into existence a commercially different and distinct commodity? In fact, *Pio Food Packers* has answered that question affirmatively. If we interpret section 2 (29BA) in the context of the case-holdings of both *Chowgule* and *Pio Food Packers*, the inevitable conclusion is that for the purposes of Income Tax Act, both 'manufacture' and 'process' are synonymous.

41. In *Saraswati Sugar Mills v. Haryana State Board*,⁶ the Supreme Court has held that the essence of manufacturing is changing one object into another for making it marketable.

⁶(1992) 1 SCC 418

42. In *Aman Marble Industries Pvt. Ltd. v. Collector of Central Excise*,⁷ the question was whether cutting of marble blocks into marble slabs amounted to manufacture under the Central Excise Act. In *ITO v. Arihant Tiles and Marbles (P) Ltd.*,⁸ the Supreme Court has noted that in *Aman Marble Industries* the question concerned "manufacture" but not "production". It has further noted that in *Arihant* the issue required the determination of what "production" is in the context of Section 80IA of the IT Act. According to it, "production" has a wider meaning as compared to the word "manufacture". Further, when one refers to the word "production", it means "manufacture plus something in addition thereto".

43. Then, elaborating on the interpretative intricacies and the precedential problems, *Arihant* cautions that the Court has to go by the facts of each case. In each case one has to examine the nature of the activity undertaken by an assessee. Mere extraction of stones may not constitute manufacture. Similarly, after extraction, if marble blocks are cut into slabs per se will not amount to the activity of manufacture.

44. On facts, *Arihant* has held that the process involved not only of cutting the marble blocks into slabs but also of "polishing and ultimate conversion of blocks into polished slabs and tiles". According to *Arihant*, "there is certainly an activity which will come in the category of 'manufacture' or 'production' under Section 80IA of the Income Tax Act. We may note that *Arihant* has treated both manufacture and production as synonymous. Rather, it has treated 'production' as more expansive than 'manufacture' and as inclusive of 'manufacture', too.

7157 ELT 393(SC)

8(2010) 2 SCC 699

45. The Assessee's own case on an earlier occasion—*CIT v. Sesa Goa Ltd.*,⁹—has articulated the same view. In that case, the word "production" came to be interpreted. The question was whether the Tribunal was justified in holding that the assessee was entitled to deduction under Section 32A of the IT Act in respect of the machinery the Assessee used in mining activity. This question was in the face of the fact that the Assessee was engaged in extraction and processing of iron ore, not amounting to manufacture or production of any article or thing.

46. On appeal from Tribunal, this Court held that extraction and processing of iron ore did not amount to "manufacture". It has, however, concluded that extraction of iron ore and the various processes would involve "production" within the meaning of Section 32A(2)(b)(iii) of the IT Act. So, it has declared that the Assessee was entitled to the benefit of investment allowance under Section 32A of the Act. Eventually, the Apex Court has upheld this Court's view. It has, in fact, held that the word "production" is wider in ambit and it has a wider connotation than the word "manufacture".

47. In *CIT v. Fateh Granite (P) Ltd.*,¹⁰ this Court interpreted the unamended section 10B of the IT Act. It has held that the expression "manufacture" or "production" are different expressions and the word "production" has a wider meaning. The word "production" under section 10B, being analogous to the expression in section 80IB, will have to be given a wider meaning. The only difference between section 80-IB and section 10B, according to Fateh Granite, is that section 10B applicable to a 100 per cent. export oriented unit, whereas section 80-IB can be regarding any unit. In our opinion, therefore, the expression "production" will have

9271 ITR 331 (SC)

10314 ITR 32

the same meaning as in *Sesa Goa Ltd.*,¹¹ and consequently, the question framed is devoid of merits.

48 For the reasons mentioned above, we hold that on the first substantial question of law, the Tribunal has rightly rendered its findings and those findings require no interference.

Second Substantial Question Of Law:

(II) Has the Tribunal correctly directed the AO to restrict the open market right of the iron ore to average purchase value by applying section 10B (7) read with section 80 IA (8) of the IT Act though there are differences in grade/quality and though it was not at arm's length price?

(IIa) Is Tribunal right in not considering *pro rata* overhead costs in determining profits from EVUs?

49 Sub-section (7) of section 10B declares that sub-section (8) and sub-section (10) of section 80-IA shall, so far as may be, apply in relation to the undertaking referred to in this section, as they apply for the undertaking referred to in section 80-IA. So, now, let us examine section 80-IA of the Act. This provision deals with deductions regarding profits and gains from industrial undertakings or enterprises engaged in infrastructure development, and so on. As per sub-section (8), If any goods or services held for the eligible business are transferred to any other business carried on by the assessee, or if any goods or services held for any other business carried on by the assessee are transferred to the eligible business, in either case, the consideration, if any, for such transfer as recorded in the accounts of the eligible business must correspond to the market value of such goods or services as on the date of the transfer.

¹¹[2004]271 ITR 331 (SC)

50. But if the consideration does not correspond to the market value, then, for effecting deductions under this section, the profits and gains of that eligible business shall be computed as if the transfer, in either case, had been made at the market value of those goods or services as on that date. But if the computation of the profits and gains of the eligible business in the above manner presents exceptional difficulties, the Assessing Officer may compute such profits and gains on such reasonable basis as he may deem fit.

51. Indeed, according to the Explanation appended to sub-section "market value" means (i) the price that such goods or services would ordinarily fetch in the open market; or (ii) the arm's length price as defined in clause (ii) of section 92F, where transferring such goods or services is a specified domestic transaction as referred to in section 92BA.

52. Sometimes there may be a close connection between the assessee's eligible business and any other person's business. In the alternative, the courses of business between them are so arranged that the business transacted between them produces to the assessee more than the 'ordinary profits' expected from the eligible business. Then, in computing the profits and gains of that eligible business for determining the deductions under this section, the Assessing Officer shall take the profits "as may be reasonably deemed to have been derived therefrom". Nevertheless, if the above-mentioned arrangement involves a specified domestic transaction referred to in section 92BA, the profits from such transaction shall be determined having regard to arm's length price as defined in clause (ii) of section 92F.

53. To uncover this camouflage, the Act applies "arm's length price" method. Section 92F of the Act defines certain terms relevant to computation of arm's length price. As per clause (ii), "arm's length price"

means a price applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions. To appreciate the concept of “arm’s length price”, we need to remember that section 80-IA covers inter-unit transfer of goods and services by an entity claiming deductions. Arm’s length price is to be determined by applying any of the following methods: Comparable Uncontrolled Price Method; Resale Price Method; Cost Plus Method; Profit Split Method; Transactional Net Margin Method, or any other method as may be prescribed by the CBDT.

54. The Revenue has contended that the Tribunal has misapplied section 10B(7) and section 80IA(8) of the IT Act. It finds fault with the Tribunal direction to the AO to restrict the open market rate of the iron ore to average purchase value. In this context, the Revenue has contended that the Tribunal ought to have noted the differences in grade or quality. Besides, the Revenue has also insisted that the remand is restrictive; that is, the Tribunal has not given freehand to the AO to determine the issue untrammelled by the Tribunal’s observations.

55. It is a fact that the Assessee has also purchased crude ore, ROM, from outside parties, that is from the mines belonging to other parties. The price paid by the Assessee to these outside parties, according to the Tribunal, can be regarded as the best evidence for determining the market value of the crude ore the Assessee extracted from its own mine and used. Tribunal has felt that “the determination of market value requires verification” by the Revenue. So, it has restored this issue. That restoration or remand is to enable the AO to determine the market value of the crude ore the Assessee consumed, based on the value paid by the assessee for the crude ore from the third parties during the year. Thus,

there should be recomputation of the profit the Assessee derived from the 100% EOU units eligible for exemption u/s 10B.

56. In the end, the Tribunal has directed the AO “to recompute the exemption available u/s 10B to the assessee in respect of Amona as well as Chitradurga units after ascertaining the market value of the crude ores transferred by the assessee to these units from its extraction divisions. It must be based on the average market value as the assessee has paid to the third-party suppliers the crude ore. And the determination must be after the AO’s giving proper and sufficient opportunity to the assessee to adduce material evidence in this regard.

57. At any rate, we reiterate that the remand or the restoration of the issue is complete, and the AO shall determine the price untrammelled by the Tribunal’s observations, if any. And that determination is in accordance with law and only after accounting for the quality or grade of the iron ore supplied.

Third Substantial Question of Law:

(III) Has the Tribunal correctly deleted the disallowance of ₹12.29 crore under section 14A of the IT Act in accordance with Rule 8D of IT Rules as held by the Mumbai Special Bench at Tribunal in *ITO v. Daga Capital Management Pvt. Ltd.*?

58. As the record reveals, the Assessee has contended that it has borrowed no funds for the investment in mutual funds. So, it has not debited any interest. In other words, the Assessee has merely parked its surplus funds in mutual funds. Nor has the Assessee invested in any equity shares. So it has not analysed the market conditions, stock investments, and so on. That is how the Assessee claimed the disallowance at ₹25,78,156/-.

59. The AO was not satisfied with the disallowance and applied Rule 8D of the Rules. In fact, the AO accepted that the Assessee borrowed no money for investing but applied Rule 8D and made disallowance @0.5% of the average amount of investments at the beginning and at the closing of the year.

60. To reject the disallowance the Assessee claimed, the AO has reasoned that (a) the Assessee incurred no administrative expenditure on earning the dividend, (b) the disallowance the Assessee made towards the administrative expenditure is very low considering the magnitude of the investments and dividend received, and (c) an investment of this magnitude cannot be made without a proper analysis of the market condition or stock movement. On appeal, the CIT (A) reckoned that the method Assessee adopted was erroneous and flawed and that the AO was fully justified in invoking Rule 8D. It has, thus, confirmed the AO's findings.

61. The Tribunal has reversed those concurrent findings. To do so, it has reasoned that the Assessee's primary business is mining, which definitely requires a huge manpower compared to the business of investing surplus funds with mutual funds; the latter is an insignificant activity. Thus, the salary expenses of the entire staff cannot be allocated proportionately between taxable and exempt incomes as averred by the CIT (A).

62. The Tribunal has further held that the AO ought to have pointed out the expenses the Assessee actually incurred for earning the exempt income and the discrepancy in the computation of disallowance. But he made no such effort. The Assessee itself showed a "reasonable amount of expenditure" of over ₹25.78 lacs, including salaries. But the AO did not record his satisfaction why the disallowance made by the Assessee

was incorrect. The AO also made no disallowance under Rule 8D (1)(i). The CIT (A), according to the Tribunal, tried to justify the application of Rule 8D by the AO “on surmises and presumptions which is not permissible at all”. And the Tribunal’s final finding is that CIT (A) has applied section 80HHC, which is entirely a different code for an entirely different purpose. It terms the CIT (A)’s approach preposterous. The basis of 10% adopted by the CIT (A), the Tribunal points out, “cannot be considered while computing disallowance u/s 14A. If that basis was to be adopted then there was no need to introduce Rule 8D”.

63. Indeed, section 14A is a pivotal provision. Inserted by the Finance Act 2001 with retrospective effect from 1 April 1962, section 14A aims to disallow expenditure incurred in relation to income which did not form part of the total income under the IT Act. This section has to be read with Rule 8D, which provides the method of calculation of disallowance under this section. Section 14A statutorily recognises the principle that tax is leviable only on the net income. That is, the profits and gains of business or profession are taxed after deducting expenditure from income. In that regard, the assessee need not establish a one-to-one correlation between income and expenditure. The provision reads:

Section 14A. Expenditure incurred in relation to income not includible in total income.—

(1) For the purposes of computing the total income under this Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act.

(2) The Assessing Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of the total income under this Act, in accordance with such method as may be prescribed, if the Assessing Officer, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of such

expenditure in relation to income which does not form part of the total income under this Act.

(3) The provisions of sub-section (2) shall also apply in relation to a case where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income under this Act:

Provided that nothing contained in this section shall empower the Assessing Officer either to reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154, for any assessment year beginning on or before the 1st day of April 2001.

64. Rule 8D of the Income Tax Rules provides the methods for determining the expenditure in relation to income not includible in the total income. But this Rule comes into play once an expenditure falls within the mischief of section 14A of the IT Act. We need not elaborate on that Rule.

65. Section 14A refers to 'income which does not form part of total income under the Act'; it does not refer to 'income which does not form part of the total income in the hands of the assessee'.

66. As part of the substantial question of law, this Court wanted to examine whether the Tribunal's impugned judgment disregards the ratio of the Tribunal's earlier judgment in *Daga Capital Management*. This Court, both as a court of record and as an appellate court under the IT Act, can resolve the issues—that is the substantial questions of law presented to it—uninfluenced by the lower forum's inconsistent, if ever, approach on a common issue. In *Daga Capital Management*, the question was whether section 14A of the IT Act, 1961 applies to dividend income earned by the assessee “engaged in the business of dealing in shares and securities, on the shares held as stock-in-trade and when earning of such dividend income is, therefore, incidental to trading in shares”. Given the

factual disparity, we need not examine the Tribunal's decision in *Daga Capital Management*.

67. To cut short our discussion, we may rely on this Court's earlier decision (rendered by this very Bench) on identical facts. In *CIT v. Sociedade De Fomento*,¹² this Court has relied on its earlier judgment in *CIT, Goa v. M/s. Sociedade De Fomento Industrial Pvt. Ltd.*¹³ In that case, one of the substantial questions of law was identical to the one before us. Rejecting the Revenue's contention, this Court has noted that the respondent invested certain funds in exempted categories such as mutual funds; it earned income. During the assessment year, income from such sources stood exempted under section 10(35) of the IT Act. The only issue was whether the respondent incurred any expenditure while earning that exempted income and whether it included that expenditure in the common indirect expenditure of its own. The Court ruled in the respondent-assessee's favour. First, unlike *Sociedade De Fomento*, the AO accepted that the Assessee had not borrowed funds. Second, the Assessee has deducted certain proportionate expenditure, which the AO has not disbelieved or disputed. Finally, given the volume of investment, the Assessee is said to have received charge-free services from the banks and other financial institutions with whom they have invested. So there is said to be no expenditure.

68 We reckon the ratio *Sociedade De Fomento* squarely applies to this case. And, thus, the third substantial question of law, too, shall stand answered against the Revenue. And it does.

Result:

¹²[2020] 429 ITR 358 (Bom)

¹³(Decided 22 October 2020)

All the substantial questions of law are answered against the Revenue and for the Assessee.

TXA No.14 of 2013

69. This, too, is an appeal the Revenue has filed. In this, it attacked certain portions of the Tribunal's impugned judgment, dt.08.03.2013, and applied for correction. The Tribunal refused to entertain that application. So it has come to this Court. The Assessee raised a preliminary objection; that is about the appeal's maintainability.

70. But we need not visit that technical objection. In TXA No.13 of 2013, the Revenue has comprehensively challenged the Tribunal's judgment. Now, that challenge stands repelled; the impugned judgment has sustained itself. So, a collateral appeal pointing out certain portions to be wrong carries no conviction in the face this Court's imprimatur to the Tribunal's judgment as a whole.

71. Therefore, TXA No.14 of 2013 needs no adjudication.

TXA No.25 of 2013

72. This is another appeal the Revenue has filed. It is more to avoid the principle of res judicata applying to the findings that to challenge any findings for the first time.

73. To be explicit, before the Tribunal both the Revenue and the Assessee have appealed. The Assessee's appeal was allowed and the Revenue's dismissed. The Revenue filed TXA No.13 of 2013 and TXA No.25 of 2013: one to challenge the part of Tribunal's judgment that allowed the Assessee's appeal and the other to challenge the part of the Tribunal's judgment that dismissed the Revenue's appeal. The above judgment, now rendered in TXA No.13 of 2013, squarely answers all

issues in TXA No.25 of 2013. So, no fresh or further adjudication is required.

74. Thus stands TXA No.25 of 2013 dismissed.

In view of disposal of Tax Appeals No.13 & 14 of 2013, nothing survives in Stamp Number Applications No.3436 & 3428. Hence, disposed of as infructuous.

DAMA SESHADRI NAIDU, J.

M.S. SONAK, J.

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