IN THE INCOME TAX APPELLATE TRIBUNAL AT AHMEDABAD
AHMEDABAD "B" BENCH
(BEFORE DR.O.K. NARAYANAN, VICE-PRESIDENT AND SHRI MAHAVIR SINGH, JUDICIAL MEMBER)

ITA No.1037/Ahd/2005
[Asstt.Year: 2001-2002]

Arvind Fashions Ltd. Arvind Mills Premises Naroda Road, Ahmedabad 380 025.	Vs.	ACIT, Cir.1 Ahmedabad.

ITA No.1304/Ahd/2005
[Asstt.Year: 2001-2002]

ACIT, Cir.1 Ahmedabad.	Vs.	Arvind Fashions Ltd. Arvind Mills Premises Naroda Road, Ahmedabad 380 025.

Assessee by : Shri S.N.Soparkar
Revenue by : Shri B.S.Gehlot

Date of Order Reserved : 16-12-2009

O R D E R

PER DR.O.K. NARAYANAN, VICE-PRESIDENT: These are two cross appeals filed by the assessee and the Revenue. The relevant assessment year is 2001-2002. These cross appeals are directed against the order of The CIT(A)-V at Ahmedabad passed on 7-1-2005 and arise out of the assessment completed under Section 143(3) of the Income Tax Act, 1961.

2. The first ground raised in the appeal filed by the assessee relates to computation of the deduction under Section 80IB that the CIT(A) has erred in confirming the estimate made by the AO in bifurcating the

income attributable to manufacturing and trading activities of the assessee company.

3. The assessee is carrying on manufacturing as well as trading activities and therefore, it is necessary to segregate the profit/loss for computing the deduction available under Section 80IB. The lower authorities have adopted a blanket view that exact bifurcation of income/ loss is not possible in this case for the reason that separate books of accounts are not maintained by the assessee-company. But the important point overlooked by the lower authorities is that if the details and nature of transactions entered in the common books of accounts and supporting subsidiary registers are identifiable with reference to the manufacturing activities and trading activities, it is not impossible to work out almost the exact amount attributable to the above two different activities. Therefore, in cases where separate books of accounts are not technically maintained, the division of income/expenditure on an estimate basis is not a *fait accompli*. Even in such cases, it is possible to decipher a proper division on the basis of the details reflected in the books of accounts. Therefore, we find that the lower authorities have erred to the above extent while appreciating the merit of the submissions made by the assessee-company.

4. The ITAT, Ahmedabad 'A' Bench has considered the very same issue in the case of an associate concern of the assessee, M/s. Arvind Cloth Ltd. Vs. ACIT in their order dated 60-11-2009 in ITA No.1471 and 1677/Ahd/2005 relating to the assessment year 2001-2002. The Tribunal has held that it may be possible for the assessee, if an opportunity is given, to work out approximately the correct amount of

income/expenditure attributable to the twin activities. In order to facilitate the above task, the issue has been remitted back to the AO.

5. In these circumstances, it is our considered view that it is only fair that the AO is directed to re-examine the issue after giving assessee an opportunity for furnishing the details so that appropriate amounts can be worked out which are attributable to the manufacturing vis-à-vis trading activities. This issue is accordingly remitted back to the AO for fresh computation.

6. The next ground raised by the assessee again relates to the computation of deduction under Section 80IB. The case of the assessee is that the CIT(A) has erred in upholding the order of the AO in treating the entire amount of other income of Rs.69,42,058/- as not derived from the business of the eligible industrial undertaking. It is the case of the assessee that the CIT(A) has erred in excluding the above amount from the ambit of Section 80IB.

7. The break-up and details of "other income" amounting to Rs.69,42,058/- are given in para-3, page-11 of CIT(A)'s order. The abstract is as follows:

Sr.No.	Particulars	Amount
1.	Interest others (Bank Deposit)	1,55,000
2.	Duty Draw Back	26,43,000
	Misc. Income	
3.	Misc. Income i.e. sale of scrap	1,17,849
4.	Sale of export quota	1,26,581
5.	Stock adjustment	31,52,697
	Other income	
6.	Penal charges on del. Deposits	5,11,688

	i.e. interest on delayed deposit of sale proceeds by franchisees/dealers.	
7.	Penal charges on del. Deposit (wrangler) i.e. interest on delayed deposit of sale proceeds by franchisees/dealers	10,970
8.	Other Income	2,24,273
	Total	69,42,058

8. It is convenient for us to discuss the issue item-wise as given in the above format.

i) The first item is interest earned on bank deposits amounting to Rs.1,55,000/-. This interest is in the nature of "unearned income" and cannot be treated as income derived from the unit eligible for deduction under Section 80IB. "Derived of income" connotes "an intimate nexus" which is genetic as well as functional. The Hon'ble Supreme Court in the case of Pandian Chemicals Ltd. Vs. CIT, 262 ITR 278 has discussed the law on the subject and has held that similar interest income cannot be considered as income derived from the eligible industrial unit. In view of the above, we uphold the decision of lower authorities on this point and hold that the bank interest of Rs.1,55,000/- is not eligible to be considered for the purpose of section 80IB.

ii) Next item is Duty Draw Back amounting to Rs.26,43,000/- This amount also cannot be considered for quantifying the deduction under Section 80IB in view of the recent judgment of the Hon'ble Supreme Court in the case of Liberty India Ltd. Vs. CIT,

317 ITR 218. The lower authorities have rightly excluded the said amount from the ambit of section 80IB.

iii) The next item in the list is the income earned by the assessee on sale of scrap. Scrap is essentially a remainder portion of the raw-materials/ finished goods. Scrap generates out of the inventories processed or out of the sales rejects or quality rejects etc. It is therefore clear that the scrap integrally forms part of the manufacturing activity of an industrial unit. It is essentially an incidental result of the activities carried on by an industrial undertaking. The Hon'ble Gujarat High Court in the case of DCIT Vs. Harjivandas Juthabhai Zaveri, 258 ITR 785 has considered a similar issue. The issue considered by the court in that case was the amount received by the assessee for job work, empty soda ash, *bardana*, empty barrels, plastic wastes etc. The court held that those amounts are eligible to be considered for deduction available under Section 80IA. Accordingly, we accept the contention of the assessee and direct the assessing authority accordingly.

iv) The next item is sale of export quota amounting to Rs.1,26,581/-. This amount cannot be considered eligible for deduction under Section 80IB in view of the judgment of the Hon'ble Supreme Court in 317 ITR 218.

v) Fifth item is the stock adjustment amounting to Rs.31,52,697/-. The stock adjustment amount represents the various personal accounts of parties dealing with the assessee who are liable to pay to the assessee for shortage of goods and

materials. Therefore, this income is generated directly from the business turnover of the stock and materials handled by the assessee in its regular activities. Therefore, this income is in the nature of direct income generated from the operational activities of the eligible industrial unit. In fact it is in the nature of "earned income". But for the manufacturing activities carried on by the assessee scrap would not have generated and in a way, this is additional sales proceeds received by the assessee from various parties. Therefore, there is no reason to exclude this amount from the computation of eligible profits for the purpose of section 80IB. We direct the AO to treat this amount of Rs.31,52,697/- as part of the eligible profits.

vi) Sixth item in the list is penal charges by way of interest on delayed deposits of sale proceeds by franchisees/dealers. The very same issue was considered by the Hon'ble Gujarat High Court in the case of Nirma Industries Ltd. Vs. DCIT, 283 ITR 402. In that case, the assessee was claiming deduction available under Section 80I on the amount of interest received on late payment of sale consideration. After examining the nature of the said interest, the Court held that the amount was in fact derived from the business carried on by the assessee and accordingly held that these amounts are includible for the purpose of Section 80I. The above ratio squarely applies to the present case as well. Accordingly, we direct the AO to treat the amount of Rs.5,11,688/- as part of 80IB profits.

vii) The seventh ground is penal charges on deposits. For the reasons stated above, this amount of Rs.10,970/- is entitled to be considered as part of 80IB profits.

viii) The last item in the list is other income amounting to Rs.2,24,273/-. No details are available regarding the nature of the composition of the above amount. Therefore, it is not possible for us to hold that the said amount must be treated as part of Sec. 80IB profits. The lower authorities are justified in excluding the said amount of Rs.2,24,273/- while computing the profits eligible for deduction under Section 80I.

9. After considering the issue raised by the assessee in respect of computation of deduction under Section 80IB, we may proceed to the disputes raised in the context of deduction claimed under Section 80HHC. Again we have to refer to the extract of various items of income considered for deciding the matters relating to 80IB.

i) The bank interest of Rs.1,55,000/- cannot be considered as part of export income and therefore not eligible for the benefit of Section 80HHC.

ii) Duty Draw Back of Rs.26,43,000/- has to be considered as part of business profits while computing the deduction under Section 80HHC in the light of the Taxation Laws Amendment Act, 2005, but subject to the conditions prescribed in the amended law. Therefore, this issue is remitted back to the assessing authority to decide the matter in accordance with law.

iii) The next item is income against the sale of scrap amounting to Rs.1,17,849/-. We have already held in the context of Section 80IB that the income against the sale of scrap is essentially income generated from the operational activities of the assessee. Therefore, it is in the nature of business income. Accordingly, the said amount of Rs.1,17,849/- needs to be treated as part of business profits for the purpose of Section 80HHC. This issue is decided in favour of the assessee.

iv) The next issue is the sale of Export Quota amounting to Rs.1,26,581/-. This issue is also remitted back to the AO at par with our decision on the item of Duty Draw Back discussed above.

v) The next item is stock adjustment income amounting to Rs.31,52,697/-. As already stated in the context of Section 80IB, the said income has been derived by way of recoveries made from dealers/show rooms towards discrepancy in the stock of goods manufactured by the new industrial undertaking. As elaborately considered alone in the order, this income is essentially in the nature of operational income of the industrial unit. This is the business income of the assessee. Therefore, it is to be treated as part of business profit for the purpose of section 80HHC.

vi) The next two items are penal charges of Rs.5,11,688/- and Rs.10,970/-. These amounts have already been held to be business income while discussing the issues of section 80IB. Accordingly, we direct the AO to treat these two amounts as

part of business income for computation under Section 80HHC.

vii) The last item is that of other income amounting to Rs.2,24,273/-. In the absence of details, the arguments of the assessee on this amount are rejected.

10. We have adjudicated all the relevant issues in this appeal filed by the assessee. The assessing authority is directed to revise the computation of deductions available to the assessee under Sections 80IB and 80HHC in the light of our directions contained in the above paragraphs. It is to be further seen that while granting the deductions both under Sections 80HHC and 80IB, no simultaneous and independent deductions would be allowed. The deductions shall first be allowed under Section 80IB and deduction under Section 80HHC shall be allowed on the remainder profits. This direction is in the light of the Special Bench decision of Appellate Tribunal in the case of ACIT Vs. Hindustan Mint and Agro Products Pvt. Ltd., 315 ITR 401 (AT)(SB).

11. The above appeal filed by the assessee is partly successful.

12. Next we will consider the appeal filed by the Revenue.

13. The only ground raised by the Revenue in its appeal is that the CIT(A) has erred in directing the AO to allow royalty expenses of Rs.49,77,894/- as revenue expenditure.

14. The assessee-company has paid a royalty amount of Rs.1,99,11,576/- to M/s.Wrangler Apparel Corporation and H.D. Lee Co. Inc. This payment was made for availing the technical know-how on the

basis of relevant agreement entered into between the parties. The AO on examination of the relevant articles of the technical know-how agreement came to a finding that the entire payment of Rs.1,99,11,576/- cannot be treated as revenue expenditure eligible for deduction in computing the taxable income of the assessee for the impugned assessment year 2001-2002. In the opinion of the AO, the procurement of know-how and technical expertise as a result of the technical agreement, has bestowed on assessee, an amount of enduring benefit for the purpose of its business and therefore, a reasonable portion of the payment has to be treated as capital in nature. On the basis of the above finding, the AO treated 25% of the royalty payment as capital expenditure not eligible for deduction. This partial disallowance amounted to Rs.49,77,894/-.

15. When this matter was taken up in first appeal, the CIT(A) examined the issue in a detailed manner. He also considered the judicial pronouncements relied on by the assessing authority as well as those decisions relied on by the assessee. Finally, he came to a conclusion that the entire payment made by the assessee to M/s.H.D.Lee Co. Inc. and Wrangler Apparel Corporation was in the nature of revenue expenditure allowable as deduction under Section 37(1) of the Income Tax Act, 1961. Accordingly, he deleted the disallowance of Rs.49,77,894/-. The Revenue is aggrieved and therefore the appeal before us.

16. The learned Commissioner appearing for the Revenue heavily relied on the judgment of the Hon'ble Supreme Court in the case of Southern Switchgear Ltd., 232 ITR 359 where the Hon'ble court upheld the disallowance of a portion of technical aide fee and royalty paid by the assessee against the amount of technical aide for setting up factory and

right to sell products. The learned Commissioner has also referred to the various decisions relied on by the assessing authority in Transformer & Switchgear Ltd. Vs. CIT, 103 ITR 352, Fenner Woodroffe & Co. Ltd. Vs. CIT, 102 ITR 665 and M.R.Electronic Components Ltd. Vs. CIT, 136 ITR 305 etc.

17. The learned Commissioner explained that even though the technical agreement stipulates that the assessee has to return all the technical materials provided by the H.D.Lee Co. Inc., knowledge and expertise acquired by the assessee company in the course of utilizing these technical materials are in the nature of an intangible asset having value of endurance and in such circumstances, a partial disallowance made by the assessing authority was only legitimate.

18. The learned counsel for the assessee, on the other hand, relied on the judgment of the Gujarat High Court in the case of Jyoti Electric Motors Ltd. Vs. CIT, 237 ITR 280 (Guj). The learned counsel pointed out that in the said case, the payment was made as a percentage of the sales turnover of the assessee-company and in such circumstances, the Court held that the payment was in the nature of revenue expenditure and therefore entitled to be deducted in computing the taxable income. The learned counsel explained that in the present case also the assessee was paying royalty as a percentage of the sales turnover. The learned counsel further explained that the technical agreement executed in the present case was only for a short period of four years out of which the assessee had no occasion to procure any technical expertise to be treated as a benefit of enduring nature. He explained that the assessee-company was bound to return all the technical materials to the foreign collaborators

after the expiry of the agreement and the assessee did not have any right whatsoever either in the technology or patent of the collaborator or in the trade mark or whatsoever. In such circumstances, the assistance obtained from the foreign collaborator was only a necessary ingredient for running of the business in the ordinary course and does not partake the character of acquiring any intangible asset for future exploitation.

19. We considered the matter in detail. A salient feature of the technical agreement was that the royalty payment was to be worked out as percentage of sales turnover of the assessee-company. The period of agreement was four years; all the technical details and materials have to be returned to the foreign collaborators after expiry of four years; the assessee surrenders all rights of every sort arising out of the technical agreement on expiry of the agreement period and assessee does not have any right either in the manufacturing technology or process techniques or other technical aspects or any marketing facilities like trade mark, patent etc.

20. When the nature of the payment was examined in the light of the above parameters of the technical agreement, it is clear that the assessee has not acquired any exploitable asset in the nature of technical know or manufacturing procedure or by way of patent or trade mark. After the expiry of the period of the agreement, the assessee has no right to rely on the technical resources available with the foreign collaborators. If at all, the assessee-company has acquired any expertise or knowledge in its business process as a result of the deployment of the agreement, that knowledge/expertise amounts only to a working experience and does not

amount to an asset or expertise capable of future exploitation. It is very pertinent to note that the payment of royalty related to the turnover achieved by the assessee from year to year. It directly brings home the point that the services obtained by the assessee were in the nature of facilities for running the business in the ordinary course and not in for obtaining any fundamental technical facility. The facility obtained by the assessee from the technical agreement was in fact to help the assessee to run its business in a more competent manner. Therefore, it is to be seen that the royalty paid by the assessee was in the nature of expenditure incurred for running an existing business in a better way.

21. In the above facts and circumstances, it is not possible to agree with the view of the Revenue that by virtue of utilizing the facility as per the technical agreement for a period of four years, the assessee company has acquired a benefit of enduring nature. The assessee has not built up any technical base or acquired any intangible asset of perpetual use. Therefore, we agree with the CIT(A) that there was no justification for treating 1/4th of the royalty payment as capital expenditure. The CIT(A) is justified in deleting the said partial disallowance.

22. Another aspect to be considered in this context is that the AO has not taken seriously the arguments of the assessee that the nature of royalty payment made by the assessee was examined by the assessing authority for the earlier assessment year 1995-96 in a detailed manner and accepted the contention of the assessee that the payment was in the nature of revenue expenditure. This finding arrived at by the assessing authority for the earlier assessment year 1995-96 has since then been followed in all the subsequent assessment years and therefore without any change in

the facts of the case, there was no provocation to take a different view for the impugned assessment year 2001-2002. The contention of the assessee-company was turned down by the assessing authority stating that *Res Judicata* does not apply to tax matters.

23. There is no doubt regarding the Rule of *Res Judicata* in tax matters. Hon'ble Supreme Court in the case of Willy Slany Vs. State of Madhya Pradesh, 1995 (2) SCR 1140 has held that there is no such fact as a judicial precedence on the facts that counsel and even judges are sometimes prone to argue and to act as if there were. The Hon'ble Kerala High Court in the case of CIT Vs. Kalpatta Estate Ltd., 211 ITR 635 has held that *res judicata* does not apply to tax assessment proceedings and different views are possible in the assessments of different assessment years, if materials are available or more closure and more intelligent analysis is made. Therefore, there is no doubt that the Rule of *Res Judicata* as such, has no application to income tax proceedings. We agree with the AO on that established proposition of law.

24. But it is also necessary to remember that non-applicability of the Rule of *Res Judicata* in income-tax matters should not unnecessarily disturb the established Rule of Consistency to be followed on factual matters repeated from assessment year to assessment year.

25. Hon'ble Supreme Court in the case of Union of India and Anr. Vs. Kaumudini Narayan Dalal and Another has considered the relevance of the Rule of Consistency in matters of income tax assessment. The Supreme Court has held in the said case that it was not open to Revenue to accept the earlier judgment in the case of one assessee and challenge

its correctness without just cause in the case of other assessee. Again the Hon'ble Supreme Court in the case of CIT Vs. Narendra Doshi, 254 ITR 606 has upheld the Rule of Consistency while deciding the tax matters. The view was again reiterated by the Hon'ble Supreme Court in the case of ACIT Vs. Nirma Pvt. Ltd., 257 ITR 57.

26. When we are in between the Rule of *Res Judicata* and Rule of Consistency, it is necessary to examine whether the Rule of Consistency is followed fairly and at the same time the Rule of Consistency is blindly applied in blatant violation of Rule of *Res Judicata*. We have to read down the rule in such a manner that the findings are not disturbed unless there are demanding circumstances and earlier decisions are not thrust upon without examining the factual matrix of subsequent assessment years. In the present case, the issue of payment of royalty has been scrutinized and examined by the assessing authority for the earlier assessment year 1995-96 in a detailed manner and had come to a finding that the payment was in the nature of Revenue expenditure. This finding arrived at after sufficient examination of the facts of the case including the terms of technical agreement has been followed by the Revenue consistently for the succeeding assessment years as well. The position being so, if the assessing authority has to take a different view on the subject for the impugned assessment year 2001-2002, it is always necessary that the AO should demonstrate the compelling circumstances of facts, which would justify the deviation from the earlier finding. The AO should have pointed out that certain pertinent clauses in the agreement were overlooked by the earlier authorities or subsequent developments have made out a case against following the earlier decision.

A mere review is not possible. The re-reading of technical agreement and understanding the terms of agreement in the manner of opinion are not provocative reasons to deviate from the earlier finding and to cut off the chord of consistency running through the assessment for so many years. The chord of consistency can be cut off only if the facts are substantially different from the earlier assessment years, capable of leading to a different finding.

27. It is our considered view that the assessing authority has erred in overlooking the finding arrived at on the same subject for the earlier assessment years as there are no demanding circumstances for a deviation. On this ground itself, the disallowance made by the assessing authority has to be held unlawful.

28. In result the appeal of the assessee is partly allowed and the appeal of the Revenue is dismissed.

Order pronounced on Friday this 18th day of December, 2009.

Sd/-	***Sd/-***
(MAHAVIR SINGH)	(DR.O.K. NARAYANAN)
JUDICIAL MEMBER	VICE-PRESIDENT

Place : Ahmedabad
Date : 18-12-2009
Copy of the order forwarded to:

1) : Assessee
2) : Respondent
3) : CIT(A)
4) : CIT concerned
5) : DR, ITAT.

BY ORDER/DR, ITAT, AHMEDABAD