IN THE INCOME TAX APPELLATE TRIBUNAL
AHMEDABAD D BENCH, AHMEDABAD
[Coram : Shri Pramod Kumar AM and Shri Kul Bharat JM]

ITA No. 1668/ AHD. / 2006
Assessment year: 2002-03

Micro Inks Ltd ***……Appellant***
(formerly known as Hindustan Inks and Resins Ltd.)
Bilakhia House,Muktanand Marg,
Chala,Vapi [PAN : AAACH 7063 F]

Vs

Assistant Commissioner of Income Tax
Vapi Circle, VAPI ***……Respondent***

ITA No. 1442/ AHD. / 2006
Assessment year: 2002-03

Assistant Commissioner of Income Tax
Vapi Circle, VAPI ***……Appellant***

Vs.

Micro Inks Ltd ***……Respondent***
(formerly known as Hindustan Inks and Resins Ltd.)

ITA No. 3453/ AHD. / 2007
Assessment year: 2002-03

Assistant Commissioner of Income Tax
Vapi Circle, VAPI ***……Appellant***

Vs.

Micro Inks Ltd ***……Respondent***
(formerly known as Hindustan Inks and Resins Ltd.)

ITA No. 1669/ AHD. / 2006
Assessment year: 2003-04

Micro Inks Ltd ***……Appellant***
(formerly known as Hindustan Inks and Resins Ltd.)

Vs

Assistant Commissioner of Income Tax
Vapi Circle, VAPI ***……Respondent***

ITA No. 1762/ AHD. / 2006
Assessment year: 2003-04

Assistant Commissioner of Income Tax
Vapi Circle, VAPI ***……Appellant***

Vs.

Micro Inks Ltd ***…….Respondent***
(formerly known as Hindustan Inks and Resins Ltd.)

ITA No. 3143/ AHD. / 2008
Assessment year: 2003-04

Assistant Commissioner of Income Tax
Vapi Circle, VAPI ***……Appellant***

Vs.

Micro Inks Ltd ***…….Respondent***
(formerly known as Hindustan Inks and Resins Ltd.)

ITA No. 2583/ AHD. / 2007
Assessment year: 2004-05

Micro Inks Ltd ***…….Appellant***
(formerly known as Hindustan Inks and Resins Ltd.)

Vs

Assistant Commissioner of Income Tax
Vapi Circle, VAPI ***……Respondent***

ITA No. 2447/ AHD. / 2007
Assessment year: 2004-05

Assistant Commissioner of Income Tax
Vapi Circle, VAPI ***……Appellant***

Vs.

Micro Inks Ltd ***…….Respondent***
(formerly known as Hindustan Inks and Resins Ltd.)
Bilakhia House,Muktanand Marg, Chala,Vapi [PAN : AAACH 7063 F]

ITA No. 940/ AHD. / 2010
Assessment year: 2003-04

Assistant Commissioner of Income Tax
Vapi Circle, VAPI ***……Appellant***

Vs.

Micro Inks Ltd ***…….Respondent***

Appearances by:
Mehul K Patel, *for the assessee*
D P Gupta and T Shankar, *for the revenue*

Date of concluding the hearing : May 07, 2013
Date of pronouncing the order : August 06 , 2013

O R D E R

By Pramod Kumar :

1. These nine appeals pertain to the same assessee, involve some common issues, arising out of similar set of facts, and were heard together. The three assessment years involved are 2002-03, 2003-04 and 2004-05. There are six cross appeals for all these assessment years- three each by the assessee and the Assessing Officer, so far as income assessment is concerned, and there are three appeals by the Assessing Officer against the relief granted by the Commissioner (Appeals) so far as penalty proceedings are concerned. As a matter of convenience, all these nine appeals are being taken together for disposal by this consolidated order.

2. These appeals involve some issues relating to the determination of arm's length price and application of transfer pricing provisions. We will begin by taking up these issues together.

3. So far as the transfer pricing issues are concerned, the related grievances raised by the parties are as follows:

Assessment year 2002-03

Grievances raised by the assessee in ITA No 1668/Ahd/2006

(a) On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in upholding the action of the learned Assistant Commissioner of Income Tax in making upward adjustment of Rs.2,14,49,675/- to the total income of the appellant company on account of notional interest on loan given to subsidiary. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.

(b) On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in rejecting the principal contention of the appellant company that no upward adjustment can be made on account of notional interest charged on excess credit period allowed to its customers. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.

(c) On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) ought to have directed the learned Assessing Officer not to make any upward adjustment to the income of the appellant company on account of determining the Arm's length price of international transactions. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.

Ground nos. 7 (a), (b) and (c)

Grievance raised by the AO in ITA No. 1442/Ahd/ 2006

On the facts and in the circumstances of the case and in law, the learned CIT(A) has erred in holding that the additions (i.e. the adjustments) to the arm's length price of international transaction relating to interest on loan and relating to interest for excess credit period allowed ought to have been made by taking the interest rate for the purpose of additions, as LIBOR rate, or the American rate of interest.

(Additional Ground of appeal no. 1)

Assessment year 2003-04

Grievances raised by the assessee in ITA No. 1669/AHD/2006

(a) On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in upholding the action of the learned Assistant Commissioner of Income Tax in making upward adjustment of Rs.1,36,83,305/- to the total income of the appellant company on account of notional interest on loan given to subsidiary. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.

(b) On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in rejecting the principal contention of the appellant company that no upward adjustment can be made on account of notional interest charged on excess credit period allowed to its customers. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.

(c) On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) ought to have directed the learned Assessing Officer not to make any upward adjustment to the income of the appellant company on account of determining the Arm's length price of international transactions. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.

Grounds of appeal nos. 10(a)(b) and (c)

Grievances raised by the AO in ITA No. 1762/AHD/2006

On the facts and circumstances of the case and in law, the learned CIT(A) has erred in holding that the additions [i.e. adjustments] to the arm's length price of international transaction relating to interest on loan and relating to interest for excess credit period allowed ought to have been made by taking the interest rate for the purposes of addition, as LIBOR rate, or the American rate of interest.

(Ground of appeal No. 13)

Assessment year 2004-05

Grievance raised by the assessee in ITA No. 2583/Ahd/2007

On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in

upholding the action of the learned Assistant Commissioner of Income Tax in making upward adjustment of Rs.1,94,35,463/- to the total income of the appellant company on account of determining the arm's length price of the international transactions. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.

(Ground No. 8)

Grievance raised by the AO in ITA No 2447/Ahd/2007

On the facts and circumstances of the case and in law, the learned CIT(A) has erred in holding that the additions (i.e. adjustments) to the arm's length price of international transaction relating to interest on loan and relating to interest for excess credit period allowed ought to have been made by taking the interest rate for the purposes of addition, as LIBOR rate, or the American rate of interest.

(Ground No. 12)

4. All these grievances are somewhat interconnected and arise out of common set of facts. We will, therefore, take up these grievances together but in order to adjudicate on these grievances, it is necessary to take a careful look at the related material facts, as also the developments leading to this litigation before us, as culled out from the material on record. The assessee before us is engaged, *inter alia,* in the business of manufacturing and sale of printing inks and other intermediate and allied products. The assessee claims to be, so far as its field of business is concerned, that it was ranked first in India and it was ranked sixteenth in the world, and that the assessee, thus, is a major global player in the field of printing inks and allied activities. Having achieved a leading position in the Indian market and established a presence abroad as an exporter, the assessee explored the possibilities of physical operations in its foreign markets and to strengthen its position globally. After evaluating various possible locations, and factors such product limitation (short shelf life as inks tend to dry up quickly), climatic conditions, shipping time and repackaging needs, the assessee zeroed in on US market and the Chicago area to set up

its manufacturing presence outside India. It was for this purpose that the assessee, through its wholly owned subsidiary, Micro Inks GmbH, Austria (Micro GmbH Austria), set up a company by the name of Micro Inks Corporation Inc. (Micro USA, in short),incorporated in Delaware, USA. Micro USA was headquartered in Schaumburg, Illinois and had its manufacturing and warehousing facilities in Illinois. Micro Inc USA was carrying out manufacturing activities with the base material, i.e. ingredients, supplied by the assessee. During the relevant previous year relevant to the assessment year 2002-03, the assessee company sold finished goods worth Rs 216,99,39,792, and packing material samples worth Rs 1,06,635 to Micro USA. In addition to reporting the above transactions on Form 3CEB, the assessee also made following disclosure:

> **Some guarantees/ advances have been given by the assessee which has assisted the wholly owned subsidiary (associated enterprises) to borrow funds from banks/ financial institutions. As per TP study carried out by the assessee, guarantees/ advances issued by the assessee on behalf of its associated enterprises are said to be in the nature of quasi capital and not in the nature of any services. Accordingly, such transactions would have no adverse impact on the income of the assessee.**

5. The matter regarding ascertainment of arm's length price was referred to the Transfer Pricing Officer. While TPO had no issues with the ALP of the transactions of sale with the US based AE, i.e. Micro USA, the TPO did not approve the approach adopted by the assessee so far above treatment of advances, claimed to be in the nature of quasi capital contributions, was concerned. During the course of scrutiny by the TPO, it was noted that as per note no. 7 of the annual report on the financial statements of the Micro USA stated as follows:

> **In June 2000, the company entered into a loan agreement with HIRL** *(i.e the assessee before us now)* **and issued a note payable to HIRL***(i.e the assessee before us now)***. The note originally bore**

interest at 9% and was due in five equal annual instalments, including interest accrued to the date of payment, beginning May 31, 2002, and ending May 31, 2006. In 2002, the note, with a balance of US $ 2,640,000 was forgiven by HIRL converted to equity as a capital contribution. During the year ended March 31, 2002, the company borrowed an additional US $ 3,170,000 from HIRL *(i.e the assessee before us now)*.

6. In response to the requisition made by the Assessing Officer to furnish the details regarding the old loan and its conversion to the equity, as also regarding chargeability of interest till the conversion of loan, the assessee submitted as follows:

Under the peculiar facts of the case, the loan(s) given to MIC are akin to the shareholder's funds.

MIL is a new entrant in the US market and is facing a stiff competition where there are already established players in the ink products. MIC has huge accumulated losses in view of the fact that it faces tremendous competition on price front whereas its SGA expenses are on higher side. It was necessary for MIL to increase its capital support in order to provide capital base of MIC, especially considering losses incurred by MIC at material time.

As such, it is necessary to consider the conversion of loan into equity and non charging of interest on outstanding balances of loan before conversion into equity, in the light of economic circumstances as mentioned below.

Your goodself's attention is further invited to para 1.37 of the aforesaid OECD Guidelines which state that in certain circumstances it may be both appropriate and legitimate for a tax administration to consider 'substance over form' to consider all surrounding circumstances. It is further explained that one such circumstance arises where economic substance of a transaction differs from its form. In such a case, the tax administration may disregard the form and re-characterize it in accordance with its substance. An example, as given in the said Guideline, is an investment in the associated enterprise in the form of interest bearing debt, when, at arm's length, having regard to economic circumstances of the borrowing company, the investment would

not be expected to be structured this way. The OECD Guidelines state that in this case, it might be appropriate for a tax administration to re-characterize the investment in accordance with its economic substance with the result that loan may be regarded as a subscription of capital……..

7. It was further explained by the assessee that the amount given to the US subsidiary was a quasi capital contribution, and that its subsequent conversion into the equity was in accordance with the relevant regulations in the US and the exchange control regulations in India at the material point of time. It was also submitted that the Reserve Bank of India, vide approval dated 11th October 2001, granted the approval for conversion of this loan into equity. It was also pointed out that the intended date of conversion, as set out in the application to the Reserve Bank of India, was 1st April 2001. The details of additional advances extended on 1st August 2001, 28th September 2001 and 1st October 2001 (i.e US$ 6,80,000, US$ 4,60,000 and US $ 10,30,000) were also furnished. It was further submitted that the funds so advanced to the US subsidiary did not have any costs so far as the assessee was concerned, and that in any event, at best such cross border loans in US $ were available at the LIBOR (London Inter Bank Official Rate). The attention of the TPO was also invited to the fact that these advances were made out of EEFC accounts held abroad, and that, in terms of the RBI guidelines – as also clarified vide notification no. FEMA 19/RB-2000 dated 3rd May 2000, no permission was needed for such investments out of EEFC account upto US $ 50,000,0000. None of these contentions, however, impressed the Transfer Pricing Officer. He was of the view that , as evident from the disclosure made in Micro USA accounts, the amount received by the US subsidiary was in the nature of an interest bearing advance and even interest was actually paid on it. It was thus, according to the TPO, wrong to claim that the amount advanced was of capital nature. Not only the amount was actually of the nature of interest bearing loan, it was intended as such. The relationship was of the borrower and lender, and, therefore, even if there was business

expediency in the transaction, such a business expediency would not take the transaction outside the ambit of transfer pricing provisions. The TPO also stated that "the purpose of loan to offshore subsidiary was to enable it to establish the business, but the provisions of Section 92 would be required to be applied to attribute interest on loan to Micro Inks USA, even though there was business purpose to the transaction" . It was also noted that the rights and obligations of the assessee were not that of the shareholders, so far as this transaction was concerned. Since the US subsidiary was able to borrow from the market, i.e. from the banks and from Micro Inks GmbH, it could not be said that an independent lendor would not have given money to the Micro USA. The TPO further held that the assessee's contention to the effect that if at all ALP of interest was to be computed it should be LIBOR or the American bank rate was rejected on the ground that the loans by Indian banks, which were on the basis of LIBOR, were granted on the basis of security given by the assessee company and are such not comparable, and that the US interest rate would not be applicable as margins are charged by the US banks over and above the same. The TPO further concluded that since the weighted average cost of funds in the hands of the assessee is 11% p.a., as per its financial statements, the same rate of 11% p.a. should be adopted for computing arms length price of this advance as well. The TPO concluded by observing as follows:

> **Internationally, where money is advanced on arms length terms are lent, the interest paid on the borrowings is taken as generally indicative of arm's length interest in relation to the moneys lent. In the present case, the company's cost of funding is 11% p.a., the same is considered as an appropriate benchmark rate.**

8. Accordingly, an addition was made for arms length price of the interest @ 11% which worked out to US $ 4,22,404 and its value in INR

was taken at Rs 2,14,49,675 by adopting exchange rate of 1 US$ = INR 50.78. The TPO further noted that, as stated in the annual report of the assessee company, a credit period of 165 days was extended to the US subsidiary i.e. Micro USA. It was in this backdrop that the TPO required the assessee to explain as to what is the average credit period allowed to unrelated customers and as to why should the interest not be charged for the excess period allowed. It was explained by the assessee that the material being supplied to the Micro USA, i.e. semi finished goods, ingredients and raw materials, are not being sold to any other enterprise, and, as such, comparison is not possible. It was also explained the assessee was required to keep an inventory of these products at Micro USA, and that 92% of its entire exports, as also 50% of its entire sales, was to Micro USA. None of these submissions were accepted by the TPO. He was of the view that, taking 120 days as permissible interest free credit period, interest @11% should have been charged on the excess credit period, i.e. 165-120 days which was computed at 45 days. An amount of Rs 2,94,15,757, computed on this basis, was also added as an arms length price adjustment. Aggrieved by the adjustments so made, assessee carried the matter in appeal before the CIT(A) but without complete success. While learned CIT(A) confirmed the addition in respect of interest free advances made by the assessee to its US based subsidiary, i.e. Micro USA, and excess credit period allowed to the same in principle, the CIT(A) restricted the rate, at which the interest was to be computed, to the rate at which international loans are available. He thus concluded that, "while confirming the addition in respect of international transactions made by the TPO on merits basis, I hereby direct the Assessing Officer to rework the addition by applying the international bank rate, i.e. the LIBOR or American rate of interest as applicable to the transaction and add the resultant amount to the total income on account of undercharging of prices". None of the parties is satisfied with the conclusions so arrived at by the learned CIT(A). The assessee is aggrieved of the ALP adjustments

having been made to the value at which advances and sale transactions were entered into, the Assessing Officer is aggrieved that the adjustments should have been made by adopting 11% as the rate of interest instead of LIBOR or American inter bank rate being adopted. Broadly, the same was the position with respect to the subsequent two years, i.e. 2003-04 and 2004-05, even though there was a variation in the figures of transactions and the average cost of funds. In principle, however, the material facts and circumstances remained the same, and so was the stand of the Assessing Officer and the CIT(A). None of the parties is satisfied by the stand taken by the CIT(A) and both of them, i.e. the assessee as also the Assessing Officer, are in appeal before us.

9. We have heard the rival contentions at considerable length, we have meticulously gone through the material on record and we have conscientiously considered factual matrix of the case in the light of the applicable legal position.

10. We find that there is no dispute about the fundamental factual position that the assessee before us wholly owns Micro Inks GmbH Austria, which in turn, wholly owns Micro Ink Corporation USA. These facts are also clearly discernible from the financial statements of these two foreign companies, for the relevant previous years, as filed before us. The company to which interest free loan was given by the assessee company is admittedly a first step down subsidiary of the assessee before us and is wholly owned by the assessee before us. It is also undisputed that the amounts advanced by the assessee to this step down subsidiary were eventually converted into equity capital contribution, and that the amounts were given as an advance because, on one hand, assessee could give funds upto US $ 50 millions from its EEFC (Exchange Earners Foreign Currency) account to its subsidiary without seeking any RBI clearance also, the assessee was forbidden from making equity investment in the

foreign subsidiary without taking the RBI permission, and the assessee was required to obtain permission of the RBI for subscribing to the equity capital abroad. While notification no. FEMA 19/RB-2000 dated 3rd May 2000, a copy of which was placed before us, clarifies that no such approval is needed while making payments from assessee's EEFC account, it is a matter of record that the permission for investment in capital of foreign subsidiary was mandatory and as was also granted by the RBI on 11th October 2011 – subject to the conditions set out therein. It is also an undisputed position, and uncontroverted stand of the assessee, that the assessee before us is the sole vendor of raw materials and the semi finished goods to this step down subsidiary, and the volume of these transactions is so significant that in the relevant previous years it was as high as over 90% of total exports and over 50% of its total sales. These facts are very significant because these facts not only show the factual ownership of Micro USA, these facts also show the economic dependence of Micro USA on the assessee and *vice-versa*. The existence of Micro USA has virtually ensured the assessee of the market of its raw materials and semi finished goods in the USA, and thus effectively have a say in ink market in that part of the world. Let us, on this factual matrix, come to the principles based on which arms length price adjustments are required to be made in value of an intra associate enterprise transaction.

11. In our considered view, and as was noted in the case of VVF Ltd Vs DCIT (2010 **TII** 4 ITAT MUM TP), " **on a conceptual note, the purpose of making arms length adjustments, in prices at which transactions have been entered into with associated enterprises, is to nullify the impact of interrelationship between the associated enterprises**". The true test, must, therefore lie in answer to the question whether, but for interrelationship between the associated enterprises, would the assessee and its associated enterprise have entered into this transaction at this value, and when the answer is no, an appropriate adjustment to such

value of the transaction is clearly warranted and justified. However, we must deal with an even more fundamental question, before we can address ourselves to this question, and that question is as to what is the type of interrelationship the impact of which is sought to be nullified by the arm's length price adjustment. Section 92 A of the Income Tax Act 1961, defines associated enterprises as "**in relation to another enterprise, means an enterprise—(*a*) which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or (*b*) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise**". As evident from this statutory definition, the importance of an enterprise being an associated enterprises lies in the management, capital or control of an enterprise being in common hands –either in one of associated enterprises or in the hands of a common person other than one of these enterprises. Therefore, the question which really needs to be adjudicated is whether but for the management, capital or control being in the same hands or in the hands of the one of the associated enterprises, the associated enterprises would have entered into the transaction on the same terms. In other words, whether there is such a commercial justification for the values at which transactions have been entered or not, so as not to attract the adjustment in the arm's length price, has to essentially depend on the factors other than the factors regarding management, capital or control. In still other words, merely because the entity receiving interest free funds is a subsidiary wholly owned by the assessee cannot be reason enough to justify such loans or advances being interest free and not warranting an arm's length price adjustment, so far as transfer pricing provisions are concerned.

12. A coordinate bench of this Tribunal, in the case of VVF Ltd *(supra)*, while dealing with the arm's length price adjustment to the interest free loans to the subsidiary and dealing with the contention that advances to subsidiary, for the purpose of their business, are commercially expedient in the light of Hon'ble Supreme Court's judgment in the case of SA Builders Vs CIT (288 ITR 1), has *inter alia* observed as follows:

> **".....Unless the method on the basis of which such hypothetical prices are computed is such that costs are to be taken into account, these hypothetical prices have nothing to do with the actual costs. CUP method seeks to ascertain arms length price by taking into account prices at which similar transactions have been entered into by the assessee with unrelated parties (Internal CUP) or at which other unrelated parties have entered into similar transactions *inter se* (External CUP). None of these inputs have anything to do with the costs; they only refer to prevailing prices in similar unrelated transactions instead of adopting the prices at which the transactions have been actually entered in such cases, the hypothetical arms length prices, at which these associated enterprises, but for their relationship, would have entered into the same transaction, are taken into account. Whether the funds are advanced out of interest bearing funds or out of funds on which 14% interest is being paid, or whether such interest free advances are commercially expedient for the assessee or not, is wholly irrelevant in this context. The transaction in the present case is of lending money, in foreign currencies, to its foreign subsidiaries....."**

13. In VVF's case, the commercial expediency in advancing interest free loans was on account of ownership and control of subsidiary being in the hands of the assessee, which was recognized, in SA Builders case *(supra)*, as a significant factor for commercial expediency. However, as we have seen in the earlier discussions, such commercial expediency of granting interest free loans is wholly irrelevant because it is the impact of this interrelationship, on account of management, capital and control, which is sought to be neutralized by arm's length price adjustments.

14. In the case of Perot Systems TSI India Ltd Vs. DCIT (130 TTJ 685), another coordinate bench of this Tribunal had an occasion to deal with the arms length price adjustment with regard to interest free advances to the subsidiaries. That was a case in which the assessee, an Indian company, advanced interest-free loans to its 100% foreign subsidiaries. The subsidiaries used those funds to make investments in other step-down subsidiaries. On the question whether notional interest on the said loans could be assessed in the hands of the assessee under the transfer pricing provisions of Chapter X, the assessee argued that the said "loans" were in fact "quasi-equity" and made out of commercial expediency. It was also argued that notional income could not be assessed to tax. However, both of these arguments were rejected by a coordinate bench of this Tribunal. While doing so, the coordinate bench observed that there was no material on record to establish that the loans were in reality not loans but were quasi-capital and that there is also no reason why the loans were not contributed as capital if they were actually meant to be a capital contribution. It was observed that, "It is not the case that there was any technical problem that the loan could not have been contributed as capital originally, if it was meant to be a capital contribution". The argument of loan being in the nature of quasi capital was thus rejected on facts, though the core legal issue, i.e. whether ALP adjustments will also be warranted in case of interest free loans given as quasi capital, was left open.

15. In the case before us now, there are two important factors pertaining to this interest free loan, and both of these aspect deserve to be examined in some detail. The first important aspect of this interest free advance is that the loan is said to be in the nature of quasi capital, and it was so given because out of EEFC (Exchange Earners Foreign Currency) account, while the assessee could have given loan upto US $ 50 million, it was not open to the assessee to subscribe to the equity capital

without the permission of the Reserve Bank of India. There was thus, unlike the case of Perot Systems *(supra)* discussed above, indeed a technical problem in subscribing to the capital directly. It is also important to note that immediately upon obtaining the permission of the Reserve Bank of India, which assessee did obtain at later stages, the advances were converted into shares. Except for an amount of US $ 10,000, entire advances received by the step down subsidiary were converted into shares. It is also not in dispute that when RBI permission to convert loan into equity was sought it was sought effective from the date on which remittance was made. The second very important aspect of this interest free loan is this. In the present case, the entity receiving the interest free advances is not only a wholly owned subsidiary of the assessee company but is also playing a very significant role in its sale and distribution chain inasmuch as the assessee is sole vendor to the said concern so far as sales of raw material and semi finished goods is concerned, and it has a significant volume of transaction at almost 50% of entire sales and 90% of entire exports. Micro USA exists only to facilitate the marketing of assessee's products in US markets. The relationship on account of lending of money cannot thus be considered in isolation with these crucial business considerations. In this regard, it is useful to refer to the following extracts from the annual financial statements of Micro USA:

> Assessment year 2002-03
>
> In June 2000, the company entered into a loan agreement with HIRL and issued a note payable to HIRL. The note originally bore interest @ 9% and was due in five equal annual instalments, including interest accrued to the date of payment, beginning May 31, 2002 and ending May 31, 2006. In 2002, this note, with a balance of US $ 2,640,000 was forgiven by HIRL and converted to equity as a capital contribution. During the year ended March 31, 2002, the company borrowed an additional US$ 3,170,000 from HIRL. Purchase of raw materials from HIRL were approximately US$ 47.48 million for the year ended March 31, 2002. The company

pays HIRL for these materials 165 days from the bill of lading date. These purchases formed the majority of company's inventory expenditure for the year ended March 31, 2002……..

Assessment year 2003-04

The company has an outstanding interest free loan payable to HIRL amounting to US$ 3,170,000 at March 2003. This loan is payable on demand and has therefore been classified as short term.

The company purchased approximately US $ 40.12 million of materials from HIRL for the year ended March 31, 2003. The company pays HIRL for these materials 165 days from the bill of lading date. These purchases account for the majority of the company's inventory expenditure for the year ended March 31, 2003. …….

Assessment year 2004-05

The company had an outstanding interest free loan payable to HIRL amounting to US$ 3,170,000 at March 31, 2003.The company also received an additional interest free loan of US $ 1,000,000 in September 2003. Pursuant to the unanimous written consent of the Board of Directors' resolution dated February 27,2004, US $ 4,160,000 of the above loan was converted into Series A Preferred Stock and the remaining US $ 10,000 was repaid to the parent in March 2004.

The company purchased approximately US $ 34.13 million and US$ 40.12 million of materials from HIRL for the year ended March 31, 2004 and 2003 respectively. The company pays HIRL for these materials 165 days from the bill of lading date. These purchases account for the majority of the company's inventory expenditure for the year ended March 31, 2004 and 2003 respectively. …….

16. It is also important to bear in mind the fact that at the relevant point of time the assessee could not have invested in the shares of the step down subsidiary, without the permission of the Reserve Bank of India – as is uncontroverted stand of the assessee, and, therefore, the assessee could not also have, without the permission of the Reserve Bank of India, entered into loan agreements with a provision of conversion of

such loans equity either. It is only elementary legal position that what could not have been done directly could not have done indirectly also. There is thus not much of a merit in the stand of the revenue authorities that in the absence of a specific mention about conversion of loan into equity, it cannot be presumed that the interest free loans could not have been in the nature of quasi capital. As to the position that the relationship between the assessee and Micro USA was not of a lender and borrower simplicitor – a relationship which is essence of a loan transaction, it will be clear from the following observations in the annual financial statement of Micro USA :

> ……. As of March 31, 2002, the company had generated an accumulated deficit of US $ 27.48 million and had a net working capital surplus of US $ 3.31 million. Net cash used in operating activities for the year ended March 31, 2002 was US $ 39.49 million.
>
> Until the management is able to achieve its plan for profitable future operations, the company continues to be dependent upon the availability of financial support from HIRL, including assistance in negotiating and guaranteeing debt arrangements with company's banks. Such financial support may be subject to the approval of Reserve Bank of India. HIRL has pledged its financial support to the company through March 31, 2003. The company has a US $ 3,170,000 note payable to HIRL and HIRL either guaranteed or secured all of the company's outstanding debts at March 31,2002. HIRL is company's principal supplier of raw materials.
>
> ……
>
> During the next twelve months, ending March 31, 2004, US $ 12.70 million of debt must be paid or refinanced, and US $ 29 million is payable to the parent. The company expects to meet these obligations with the continued support and guarantees of the parent
>
> ……

> During the next twelve months, ending March 31, 2005, US $ 19.42 million of debt must be paid or refinanced, and US $ 12.48 million is payable to the parent. The company expects to meet these obligations with the continued support and guarantees of the parent

17. As is evident from the above discussions, the relationship between the assessee and its step down subsidiary Micro USA was simply that of a lender and a borrower. Not only the Micro USA was a significant part of the marketing apparatus of the assessee, and the assessee and the Micro USA had significant commercial relationship on that count, the assessee was a *de facto* and *de jure* promoter of the Micro USA. In the light of this undisputed position, and in the light of the admitted position that, even as per revenue authorities, the transaction is at best for advance of money by holding to step down subsidiary, let us examine the correctness of the arm's length price adjustment in this case. In such a case, CUP method can be applied and the LIBOR or other bank rate linked rate is generally taken as a rate for comparable uncontrolled transaction. As has been held in a large number of cases, including in VVF *(supra)* and Perot Systems *(supra),* in the cases of arm's length prices of loans and advances, costs of funds have no relevance and it is only the rate applicable for comparable uncontrolled transaction that is to be taken into account. However, even while applying CUP method, one has to bear in mind the fact that in terms of Rule 10B (1) computation of ALP under the CUP method is a three step process which requires that

> (i) the price charged or paid for property transferred or services provided in a comparable uncontrolled transaction, or a number of such transactions, is identified;
>
> (ii) **such price is adjusted to account for differences**, if any, **between the international transaction and the comparable uncontrolled transactions** or **between the enterprises entering into such transactions, which could materially affect the price in the open market;**

(iii) the adjusted price arrived at under sub-clause (ii) is taken to be an arms length price in respect of the property transferred or services provided in the international transaction;

(Emphasis by underlining supplied by us)

18. Therefore, even when we take LIBOR plus rate as the base rate for an advance in step 1 of the above computation process, such base rate will have to adjusted *inter alia* for the differences……. (a) between the international transaction and the comparable uncontrolled transaction, and (b) between the enterprises entering into such transactions, which could materially affect the price in the open market". On both of these counts, adjustments will have to be necessarily made in the LIBOR plus rate. While the international transaction before us is that of advancing an interest free unsecured loan for helping a entity overcome its teething problems and pending the approval for capital subscription is received from the Reserve Bank of India, a typical LIBOR plus rate transaction is the transaction in which banks gives secure advances, for making profits out of so lending the money, to its customers. Strictly speaking, there is no parity between these two types of transactions. Secondly, we are dealing with a situation in which the two enterprises are mutually dependent for commercial reasons. While Micro USA is dependent on the assessee for its sheer existence, the assessee is dependent on Micro USA for its business. Let us assume for a while that Micro USA is unconnected with the assessee so far as its management, capital and control is concerned, but even then and without this management, capital and control relationship, the assessee, as an independent enterprises, will make sense in giving interest free advances to Micro USA so as to ensure its continued market access in USA and for other commercial reasons. This is quite unlike a typical transaction on LIBOR plus rate in which only motivation for giving advance is earning interest. Clearly, thus, LIBOR

plus rate cannot be adopted in this situation for two fundamental reasons – (i) first, that it is not a simplictor financing transaction between the assessee and Micro USA, as it is a transaction of investing in a step down subsidiary as quasi capital pending formal capital subscription with the approval of Reserve Bank of India; and (ii) second, that it is not a case of granting advance to a business concern without significant and decisive commercial considerations, as the monies are given for strengthening assessee's marketing apparatus in US and to keep alive its biggest exports customer. There is a difference in the nature of transaction and there is also a difference in the nature of the enterprises, including their *inter se* commercial relationship, entering into this transaction. The differences are so fundamental that these differences, to use the phraseology employed in Rule 10 B (1)(a)(ii), "could materially affect the price in the open market". On account of these peculiar factors, the application of LIBOR plus rate or, for that purpose, any bank rate will be inappropriate to this case.

19. The next logical question, therefore, is as to what would be the price at which such interest free advances could be given in comparable uncontrolled transactions. In other words, in case the assessee and the Micro USA were not associated enterprises in legal sense of that expression, at what rate the assessee would have granted advances pending approval for capital subscription in a company which is playing such a vital role in its business plans. It is so for the reason, as we begun by pointing out, the whole purpose of the arm's length price adjustment is to nullify the impact of management, capital and control interrelationship between the associated parties. In our humble understanding, on the pure commercial factors and notwithstanding the management, capital and control relationship between the parties, such non interest bearing advances were equally justified even if the assessee and Micro USA were independent enterprises. Of course, we are alive to

the fact that but for the management, capital and control interrelationship, Micro USA could not have played such a strategically significant role in assessee's business but then right now we are concerned with a comparable uncontrolled transaction between independent enterprises, in which all other factors, except the commonality of management, control and capital, remain the same. The comparable uncontrolled price for interest on such a transaction in which advances are made pending capital subscription in a company which plays strategically significant commercial role in assessee's business, in our considered view, would be nil. The levy of interest would not come into play in such a case, except to the extent of refund of US $ 10,000 for which no shares were allotted. When it was so pointed out during the hearing, learned counsel for the assessee very fairly did not press his grievance to the extent of this amount. In the light of these discussions, the variations in the nature of transactions between the assessee and Micro USA and variations in the nature of relationship between the assessee and Micro USA are so fundamental that the entire LIBOR plus rate, which was the starting point of our computation of ALP of these interest free loans, is to be reduced to zero to take care of the differences in terms of Rule 10B(1)(a)(ii) of the Income Tax Rules. The impugned ALP adjustment, to this extent and in the terms indicated above, is unsustainable in law and we delete the same.

20. The only other ALP adjustment in appeal before us is with respect to, what the authorities below have treated as, excess credit period allowed to Micro USA. This adjustment must be deleted for the short reason that it was part of the arrangement that specified credit period was allowed and thus the cost of funds blocked in the credit period was inbuilt in the sale price. There is no dispute that similar products are not sold to any other concern, at same price or even any other price, and interest is levied on the similar credit period allowed to those

independent parties but not to Micro USA. The question of excess credit period arises only when there is a standard credit period for the product sold at the same price and the credit period allowed to the associated enterprises is more than the credit period allowed to independent enterprises. That is not the case here. The credit period for finished goods cannot be compared with credit period for unfinished goods and raw materials, and in any case, when products are not the same, there cannot be any question of prices being the same. Unless the prices of the product and the product are the same, and yet extra credit period is allowed, there cannot be any occasion for making ALP adjustment on the basis of the excess credit period. None of the authorities below have even disputed that the ingredients, raw materials and semi finished goods sold to Micro USA are not sold to any other concern. The very foundation of impugned addition in arm's length price on account of excess credit period is thus devoid of any legally sustainable merits or factual basis. When all these factors were pointed out to the learned Departmental Representative, he did not have much to say except to place his bland but dutiful reliance on the orders of the authorities below. However, for the reasons set out above and in the absence of any comparative price and credit period figures on comparable product to support the case of the revenue, we uphold the grievance of the assessee and direct the Assessing Officer to delete this ALP adjustment. The assessee gets the relief accordingly.

21. To sum up, so far as ALP adjustments are concerned, we uphold the plea of the assessee in the terms indicated above, and we reject the grievance of the Assessing Officer.

22. We now take up the appeals one by one.

23. We will first take up ITA No. 1668/Ahd/ 2010, i.e. assessee's appeal for the assessment year 2002-03.

24. Ground Nos. 1 and 2 are general in nature and donot call for any adjudication. Accordingly, these two grounds are summarily dismissed.

25. In ground no. 3, following grievance is raised:

> ***On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in confirming the action of the learned Assistant Commissioner of Income Tax, excluding income from wind mill to the tune of Rs.8,99,862 while granting deduction u/s. 80HHC. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.***

26. So far as this grievance of the assessee is concerned, the relevant material facts are like this. During the course of the assessment proceedings, the Assessing Officer noticed that the assessee has included income from windmills, amounting to Rs 8,99,862, in the profits of the business for the purpose of granting deduction under section 80 HHC. The assessee, however, submitted that since the assessee gets a set off of the power generated in the wind farm, the assessee has to effectively pay less charges for electricity. It was thus submitted that it is only an accounting adjustment and in effect it reduces the electricity costs. The Assessing Officer rejected this explanation and observed that since this income is not generated from the export activity, there is no good reason to include the same in profits of the business. Aggrieved, assessee carried the matter in appeal before the CIT(A) but without any success. The assessee is not satisfied and is in further appeal before us.

27. Having heard the rival contentions and having perused the material on record, we see no reasons to disturb the findings of the

authorities below. The income from windmill, whatever be the format of its credit or set off being given, is not related to the activity of exports. It was thus rightly excluded from profits of the business. We approve and affirm the conclusions arrived at by the CIT(A) and decline to interfere in the matter.

28. Ground No. 3 is dismissed.

29. In ground nos. 4, 5 and 6, the assessee has raised the following grievances:

> ***4. On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in confirming the action of the learned Assistant Commissioner of Income Tax, excluding miscellaneous income to the tune of Rs.50,88,981 while granting deduction u/s. 80HHC. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.***
>
> ***5. On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in confirming the action of the learned Assistant Commissioner of Income Tax of not granting deduction to the appellant company u/s. 80HHC of the Income Tax Act correctly as per provisions of law.***
>
> ***6. On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in confirming the action of the learned Assistant Commissioner of Income Tax, excluding miscellaneous income to the tune of Rs.5,39,887 pertaining to Daman Unit and Rs.39,19,003/- pertaining to Silvassa unit while granting deduction u/s. 80IB. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.***

30. While learned counsel for the assessee did not press ground no. 5 at all, he did not make any specific submissions on ground nos. 4 and 6 either beyond praying for one more opportunity to give specific details of

miscellaneous income so as to have a proper adjudication on this issue. Learned Departmental Representative did not seriously oppose the prayer for the matter being remitted to the file of the CIT(A). Ground No. 4 and 6 are thus allowed for statistical purposes, while ground no. 5 is dismissed.

31. Ground No 7 raises the following grievances:

> ***(a) On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in upholding the action of the learned Assistant Commissioner of Income Tax in making upward adjustment of Rs.2,14,49,675/- to the total income of the appellant company on account of notional interest on loan given to subsidiary. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.***
>
> ***(b) On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in rejecting the principal contention of the appellant company that no upward adjustment can be made on account of notional interest charged on excess credit period allowed to its customers. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.***
>
> ***(c) On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) ought to have directed the learned Assessing Officer not to make any upward adjustment to the income of the appellant company on account of determining the Arm's length price of international transactions. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.***

32. In terms of the discussions earlier in this order, and for the detailed reasons set out therein, this ground is allowed.

33. In ground no. 8, the assessee has raised the following grievance:

On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in upholding the action of the learned Assistant Commissioner of Income Tax that loss from 100% Export Oriented Unit (eligible for deduction u/s. 10B of the Income Tax Act) to the tune of Rs.5,04,12,831/- is not eligible for set off against normal business income. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.

34. In view of the fact that the revision order, whereby the above issued was raised, itself is quashed by a coordinate bench, this issue is purely academic and does not call for any adjudication.

35. Ground No. 8 is thus dismissed as infructuous.

36. Ground Nos. 9 and 10 are not pressed and are dismissed as such.

37. In the result, ITA No. 1668/Ahd/ 2006, i.e. assessee's appeal for the assessment year 2002-03 in quantum proceedings, is partly allowed in the terms indicated above.

38. We now take up ITA No. 1442/Ahd/ 2006, i.e. Assessing Officer's appeal for the assessment year 2002-03 in the quantum proceedings.

39. In ground no. 1, the Assessing Officer has raised the following grievance:

On the facts and circumstances of the case and in law, the learned CIT(A) has erred in deleting the addition on account of Foreign Travelling Expenses amounting to Rs.7,40,966/- without appreciating the fact that the assessee failed to substantiate its claim that the expenditure was incurred wholly, exclusively and necessarily for the business purpose.

40. The impugned disallowance out of foreign travel expenses was made by the Assessing Officer, on adhoc basis, at one fifth of the expenses. In appeal, CIT(A) has deleted the same and aggrieved by the relief so granted Assessing Officer is in appeal before us.

41. Learned representatives fairly agree that this issue is covered, in favour of the assessee, by order dated 17th July 2009, in assessee's own case for the assessment year 1999-2000, even as learned Departmental Representative dutifully relied upon the orders of the authorities below.

42. We see no reasons to take any other view of the matter than the view so taken by the coordinate bench. Respectfully following the same, we uphold the order of the CIT(A) and decline to interfere in the matter.

43. Ground No. 1 is thus dismissed.

44. In ground no. 2,3,4 and 5, the Assessing Officer has raised the following grievance:

> ***2. On the facts and circumstances of the case and in law, the learned CIT(A) has erred in deleting the addition of Rs.32,998/- on account of preliminary expenses.***
>
> ***3. On the facts and circumstances of the case and in law, the learned CIT(A) has erred in deleting the addition of Rs.13,84,284/- on account of oil and petrol expenses without considering the fact that the assessee failed to file the log book to establish that the vehicles were used for business purposes and it failed to substantiate its claim that the expenditure was incurred wholly, necessarily and exclusively for the business of the assessee, since part of the disallowance was made by it voluntarily.***
>
> ***4. On the facts and circumstances of the case and in law, the learned CIT(A) has erred in deleting the disallowance of Rs.58,000/- made out of the telephone expenses without considering the fact of possibility of use of telephones by the***

directors and employees of the company for non-business purposes and ignoring the fact that the assessee itself has disallowed Rs.42,000/- on this count.

5. On the facts and circumstances of the case and in law, the learned CIT(A) has erred in holding that the payments of PF and ESIC amounting to Rs.1,26,67,014/- made before filing the return are eligible for deduction without considering the fact that the due dates in the respective Acts for the said payments is 15th and 21st of every month.

45. Learned representatives fairly agree that all the above issues are also covered, in favour of the assessee, by order dated 17th July 2009, in assessee's own case for the assessment year 1999-2000, even as learned Departmental Representative dutifully relied upon the orders of the authorities below.

46. We see no reasons to take any other view of the matter than the view so taken by the coordinate bench. Respectfully following the same, we uphold the order of the CIT(A) and decline to interfere in the matter.

47. Ground No. 2, 3, 4 and 5 are also thus dismissed.

48. In ground no. 6, grievance of the Assessing Officer is as follows:

On the facts and circumstances of the case and in law, the learned CIT(A) has erred in deleting the addition made on account of Inter Division Transfer amounting to Rs.42,04,424 without going into the facts and circumstances of the case.

49. As far as this grievance of the Assessing Officer is concerned, learned representatives fairly agree that this issue is required to be remitted to the file of the Assessing Officer for fresh adjudication as in the earlier years dealt with by a coordinate bench of this Tribunal, in assessee's own case and vide order dated 17th June 2009. The

observations made in this order shall apply mutatis mutandis for this year as well, and the said order will be deemed to be attached to and forming part of this order.

50. Ground No. 6 is thus allowed for statistical purposes in the terms indicated above.

51. In ground no. 7 and 8, the Assessing Officer has raised the following grievances:

> ***On the facts and circumstances of the case and in law, the learned CIT(A) has erred in directing not to exclude the following amounts from the profits eligible for deduction u/s. 80HHC, though the same have no direct or immediate nexus with the export activity of the assessee :***
>
> ***(a) Interest income to Rs.4,53,956;***
> ***(b) Sale of Scrap – Rs.1,43,84,440;***
> ***(c) Sales of W/Off- Rs.813***
> ***(d) Exchange rate difference of Rs.1,47,45,066***
>
> ***On the facts and circumstances of the case and in law, the learned CIT(A) has erred in directing not to exclude the following amounts from the manufacturing profits eligible for deduction u/s. 80IB, though the same have no direct or immediate nexus with the manufacturing activity of the assessee as per ratio laid down by the Hon'ble Apex Court in the cases CIT –vs.- Sterling Foods (1999) 237 ITR 579 and Pandian Chemicals – vs.- CXIT (2003) 262 ITR 278 (SC)***
>
> ***(a) interest income to Rs.3,69,365/-***
> **(b)** ***Sale of scrap – Rs.75,22,493/-***
> **(c)** ***Sale W/Off – Rs.694/-***
> **(d)** ***Exchange Rate Difference of Rs.1,10,54,713/-.***

52. As far as these grievances are concerned, learned counsel for the assessee conceded the point with regard to sales write off, at item (c) above. Learned representatives also agreed that so far as interest income

is concerned, consistent with the stand taken by the coordinate benches in assessee's own case for the earlier assessment years, the netting is required to be done, and that the issue regarding sale of scrap is concerned, the same in covered in favour of the assessee by decisions of the coordinate benches in assessee's own cases. As regards the last point, i.e. exchange rate difference, learned representatives agree that in view of the undisputed fact that exports proceeds were received in time, the stand of the CIT(A) was to be confirmed.

53. In view of the above discussions, and consistent with the stand taken for the preceding assessment years, ground no. 7 and 8 are partly allowed in the terms indicated above.

54. In ground no. 9, the Assessing Officer has raised the following grievance:

> ***On the facts and circumstances of the case and in law, the learned CIT(A) has erred in directing not to exclude the export benefit receivable of Rs.26,22,21,412/- from the manufacturing profits eligible for deduction u/s. 80IB of the Act without considering the fact that it has no direct or immediate nexus with the manufacturing activity of the assessee.***

55. So far as this issue is concerned, with the consent of the parties, this issue stands restored to the file of the Assessing Officer for fresh adjudication in the light of Hon'ble Supreme Court's judgment in the case of Topman Exports vs CIT (342 ITR 49).

56. Ground No. 9 is thus allowed for statistical purposes in the terms indicated above.

57. In ground no. 10, the Assessing Officer has raised the following grievance:

> ***On the facts and circumstances of the case and in law, the learned CIT(A) has erred in deleting the addition made to the book profit u/s. 115JB in respect of loss of Rs.10,65,583/- incurred on Wind Farm Project without appreciating the fact that profit includes loss and in fact loss are negative profit and hence such loss is to be added while working the book profit u/s. 115JB of the Act.***

58. Learned representatives agree that this issue is also covered, in favour of the assessee, by order of a coordinate bench, in assessee's own case for the assessment year 1998-99. A copy of the said order was also placed before us, and is deemed to be attached to and forming part of this order as well.

59. We see no reasons to take any other view of the matter than the view so taken by the coordinate bench in assessee's own case. Respectfully following the same, we approve the conclusions arrived at by the CIT(A) and decline to interfere in the matter.

60. Ground No. 10 is also dismissed.

61. Ground No. 11 and 12 were dismissed as not pressed.

62. The Assessing Officer has also taken an additional ground of appeal which is as follows:

> ***On the facts and in the circumstances of the case and in law, the learned CIT(A) has erred in holding that the additions (i.e. the adjustments) to the arm's length price of international transaction relating to interest on loan and relating to interest for excess credit period allowed ought to have been made by taking the interest rate for the purpose of additions, as LIBOR rate, or the American rate of interest.***

63. While the ground of appeal is admitted as it is a purely legal issue on

the undisputed facts, in view of the discussions earlier in this order, and for the details reasons so set out, this grievance of the Assessing Officer is dismissed.

64. The additional ground of appeal is also dismissed.

65. In the result, ITA No. 1442/Ahd/ 2006, being Assessing Officer's appeal against the quantum assessment for the assessment year 2002-03 is partly allowed, in the terms indicated above.

66. The next appeal is ITA No. 3453/Ahd/07, i.e. Assessing Officer's appeal against the CIT(A)'s order deleting penalty imposed on the assessee under section 271(1)(c) of the Income Tax Act, 1961, for the assessment year 2002-03.

67. Grievances raised by the Assessing Officer are as follows:

> ***1) On the facts and circumstances of the case and in law, the learned CIT(A) has erred in deleting the penalty of Rs.1,81,58,959/- without considering fact that same was levied on the upward adjustment made by the TOP regarding non charging of interest on the advances given to associate concerns and subsequently confirmed in the first appeal.***
>
> ***2) On the facts and circumstances of the case and in law, the learned CIT(A) has erred in granting relief to assessee without considering the fact that by not charging interest on advances to sister concerns and claiming interest expenses on the borrowings the assessee has reduced its taxable income for the year.***
>
> ***3) It is, therefore, prayed that the order of the learned CIT(A) be set aside and that the order of the AO be restored."***

68. In view of the fact that, as earlier in the order, the quantum addition itself is deleted, the very foundation for the impugned penalty ceases to hold good in law. The penalty must stand deleted for this short reason

alone. Accordingly, we confirm the conclusions arrived at by the CIT(A) and decline to interfere in the matter. Even as we do so, since the related quantum addition itself is deleted, we see no need to address ourselves to the reasoning adopted in the orders of the authorities below. With these observations, grievances of the Assessing Officer stand rejected.

69. In the result, ITA No. 3453/Ahd/07 is dismissed.

70. To sum up, so far as assessment year 2002-03 is concerned, while cross appeals filed by the assessee and the Assessing Officer in the quantum assessment are partly allowed in the terms indicated above, the appeal filed by the Assessing Officer against deletion of penalty under section 271(1)(c) by the CIT(A) stands dismissed.

71. We now move on to the assessment year 2003-04.

72. We will first take up ITA No. 1669/Ahd/2006 i.e. assessee's appeal against the CIT(A)'s order, in the assessment proceedings, for the assessment year 2003-04.

73. Ground nos. 1 and 2, being general in nature, are not pressed. Ground nos. 1 and 2 are, therefore, dismissed as not pressed.

74. In ground nos. 3 and 4, the assessee has raised the following grievances:

> ***On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in confirming the action of the learned Assistant Commissioner of Income Tax in making addition of Rs.75,966/- out of ROC fees paid by the appellant company for increasing its authorized share capital pertaining to Vapi-I operations, Rs.1,72,618/- pertaining to Vapi-II operations, Rs.1,28,643/-***

pertaining to Daman operations, Rs.2,63,356/- pertaining to Silvassa operations and Rs.1,09,918/- pertaining to EOU operations. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.

On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in confirming the action of the learned Assistant Commissioner of Income Tax in disallowing Rs.47,054/- out of business development expenses pertaining to Vapi-I operations, Rs.1,06,922/- pertaining to Vapi-II operations, Rs.79,683/- pertaining to Daman operations, Rs.2,64,126/- pertaining to Silvassa operations and Rs.68,084/- pertaining to EOU operations. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.

75. Learned counsel for the assessee very fairly submits that these issues are covered against the assessee, by Tribunal's orders in assessee's own case, and he would not, therefore, like to press the same. Learned Departmental Representative does not object to this stand.

76. Ground nos. 3 and 4 are thus dismissed.

77. In ground no. 5, the assessee has raised the following grievances :

On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in confirming the action of the learned Assistant Commissioner of Income Tax of excluding following items of income while granting deduction u/s. 80HHC :-

.

	Silvassa	Daman	Others
Sale of export benefit	7805826	-47239	-261437
Insurance claim	20558386	594798	983714
Income from wind mill			591568

The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.

78. So far as sale of export benefits is concerned, consistent with the stand by us in the immediately preceding assessment year earlier in this order, the matter stands restored to the file of the Assessing Officer for fresh adjudication in the light of Hon'ble Supreme Court's judgment in the case of Topman Exports (supra). Similarly, so far as income from windmill is concerned, consistent with the stand taken by us in the immediately preceding assessment year earlier in this order, the grievance of the assessee is rejected. However, as regards insurance claim receipt, we find that the insurance receipt has a clear nexus with the business and is not a standalone profit activity. It cannot be seen in isolation with the business in respect of which the insurance claim is received. It was also held by the Hon'ble Delhi High Court's judgment in the case of CIT Vs Sportking India Ltd (324 ITR 283). Accordingly, this segment of the grievance is upheld and consequential relief is directed to be given.

79. Ground No. 5 is thus partly allowed in the terms indicated above.

80. In ground no. 6, 7 and 9, the assessee has raised the following grievances

> ***6. On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in confirming the action of the learned Assistant Commissioner of Income Tax in not considering other income to the tune of Rs.9,323/- as income from business for the purpose of computing deduction u/s.80HHC. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.***
>
> ***7. On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in confirming the action of the learned Assistant***

Commissioner of Income Tax of not granting deduction to the appellant company u/s. 80HHC of the income tax Act correctly as per provisions of law.

9. On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in confirming the action of learned Assistant Commissioner of Income Tax in not considering other income to the tune of Rs.9,323/- as income from business for the purpose of computing deduction u/s. 80IB. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.

81. Learned counsel for the assessee does not press the above grievances. Accordingly, ground nos. 6, 7 and 9 are dismissed as not pressed.

82. In ground nos. 8, the assessee has raised the following grievances:

8. On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in confirming the action of the learned Assistant Commissioner of Income Tax of excluding following items of income while granting deduction u/s. 80IB:-

	Silvassa	***Daman***
Sale of export benefit	***7805826***	***-47239***
Insurance claim	***20558386***	***594798***

The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.

83. So far as this ground of appeal is concerned, learned representatives agree that this issue can be restored to the file of the Assessing Officer so as the matter can be decided in the light of Topman Exports decision (supra) on the question of sale of export benefits, and in the light of examining nexus of insurance receipts with the business activity.

84. Ground no. 8 is thus allowed for statistical purposes.

85. In ground no. 10, the assessee has raised the following grievance:

> ***10.(a)On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in upholding the action of the learned Assistant Commissioner of Income Tax in making upward adjustment of Rs.1,36,83,305/- to the total income of the appellant company on account of notional interest on loan given to subsidiary. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.***
>
> ***10(b) On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in rejecting the principal contention of the appellant company that no upward adjustment can be made on account of notional interest charged on excess credit period allowed to its customers. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.***
>
> ***10(c) On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) ought to have directed the learned Assessing Officer not to make any upward adjustment to the income of the appellant company on account of determining the Arm's length price of international transactions. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.***

86. Vide our observations earlier in this order and for the detailed reasons set out therein, these grievances are upheld and the Assessing Officer is required to give relief, in the terms set out, earlier in this order.

87. Ground No. 10 is thus allowed in the terms indicated above.

88. In ground no. 11, the assessee has raised the following grievance:

On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in upholding the action of the learned Assistant Commissioner of Income Tax that loss from 100% Export Oriented Unit (eligible for deduction u/s. 10B of the Income Tax Act) is not eligible for set off against normal business income. The action of the learned Commissioner of Income Tax (Appeals) is contrary to provisions of law and deserves to be deleted.

89. Learned representatives agree that this issue is also covered, in favour of the assessee, by order of a coordinate bench, in assessee's own case for the assessment year 2002-03. A copy of the said order was also placed before us, and is deemed to be attached to and forming part of this order as well.

90. We see no reasons to take any other view of the matter than the view so taken by the coordinate bench in assessee's own case. Respectfully following the same, we uphold the grievance of the assessee. The Assessing Officer is directed to grant relief accordingly.

91. Ground No. 11 is allowed.

92. In the result, ITA No. 1669/Ahd/ 06 is partly allowed in the terms indicated above.

93. We now take up ITA No. 1762/Ahd/06 i.e. Assessing Officer's appeal against the CIT(A)'s order, in quantum assessment proceedings, for the assessment year 2003-04.

94. In ground no. 1, the Assessing Officer has raised the following grievance:

On the facts and circumstances of the case and in law, the learned CIT(A) has erred in deleting the addition made on account of Inter Division Transfer without going into the facts and circumstances of the case.

95. As far as this grievance of the Assessing Officer is concerned, learned representatives fairly agree that this issue is required to be remitted to the file of the Assessing Officer for fresh adjudication as in the earlier years dealt with by a coordinate bench of this Tribunal, in assessee's own case and vide order dated 17th June 2009. The observations made in this order shall apply mutatis mutandis for this year as well, and the said order will be deemed to be attached to and forming part of this order.

96. Ground No. 1 is thus allowed for statistical purposes in the terms indicated above.

97. In ground no. 2, the Assessing Officer has raised the following grievance:

On the facts and circumstances of the case and in law, the learned CIT(A) has erred in deleting the addition of Rs.22,000 made on account of legal and professional services without considering the fact that the expenditure is capital in nature.

98. The short reason for which this disallowance was made was because in the accounts this expenditure was described to have been incurred for "Layout drawing of factory building" in the accounts, and, as such, the amount was capital expenditure in nature. In appeal, learned CIT(A) deleted the disallowance and observed that the reasons for holding that it was capital expenditure were not sustainable in law. The Assessing Officer is aggrieved and is in appeal before us.

99. Having heard the rival contentions and having perused the material on record, we see no reasons to disturb the relief granted by the CIT(A). The mere fact that the payment is made for drawing layout in respect of a capital asset, by itself, cannot be reason enough to hold that it is capital expenditure in nature. The CIT(A) was thus quite justified in granting the impugned relief, and we confirm the same.

100. Ground No. 2 is thus dismissed.

101. In ground no. 3, the Assessing Officer has raised the following grievance:

> ***On the facts and circumstances of the case and in law, the learned CIT(A) has erred in deleting the addition on account of staff welfare expenses amounting to Rs.14,06,684/- without appreciating the fact that the assessee failed to explain that the expenditure was incurred wholly, exclusively and necessarily for the business purposes.***

102. So far as this grievance of the Assessing Officer is concerned, it is sufficient to take note of only a few material facts. In the course of the assessment proceedings, the Assessing Officer disallowed a part of staff welfare expenses on the ground that it pertains to tea, coffee, lunch and dinner etc at the workplace and a part of this expenditure is in the nature of entertainment expenses which cannot be allowed as a deduction. In appeal, CIT(A) held that such a disallowance cannot be sustained in appeal as there was no material to come to the conclusion arrived at by the Assessing Officer. The Assessing Officer is aggrieved and is in appeal before us.

103. Having heard the rival contentions and having perused the material on record, we see no reasons to interfere in the matter. There is no material before us to support the AO's stand that a part of this

expenditure is entertainment expenditure in nature. The CIT(A) was thus quite justified in granting the impugned relief and we approve the same.

104. Ground No. 3 is thus dismissed.

105. In ground no. 4, the Assessing Officer has raised the following grievance :

> ***On the facts and circumstances of the case and in law, the learned CIT(A) has erred in deleting the addition on account of foreign travelling expenses amounting to Rs.40,87,902/- without appreciating the fact that the assessee failed to substantiate its claim that the expenditure was incurred wholly, exclusively and necessarily for the purposes purpose.***

106. The impugned disallowance out of foreign travel expenses was made by the Assessing Officer, on adhoc basis, at one fifth of the expenses. In appeal, CIT(A) has deleted the same and aggrieved by the relief so granted Assessing Officer is in appeal before us.

107. Learned representatives fairly agree that this issue is covered, in favour of the assessee, by order dated 17th July 2009, in assessee's own case for the assessment year 1999-2000, even as learned Departmental Representative dutifully relied upon the orders of the authorities below.

108. We see no reasons to take any other view of the matter than the view so taken by the coordinate bench. Respectfully following the same, we uphold the order of the CIT(A) and decline to interfere in the matter.

109. Ground No. 4 is thus dismissed.

110. In ground no. 5 and 6, the Assessing Officer has raised the following grievance:

5. On the facts and circumstances of the case and in law, the learned CIT(A) has erred in deleting the addition of Rs.15,57,308/- on account of oil and petrol expenses without considering the fact that the assessee failed to file the log book to establish that the vehicles were used for business purposes and it failed to substantiate its claim that the expenditure was incurred wholly, necessarily an exclusively for the business of the assessee, since part of the disallowance was made by it voluntarily.

6. On the facts and circumstances of the case and in law, the learned CIT(A) has erred in deleting the disallowance of Rs.58,000/- made out of the telephone expenses without considering the fact of possibility of use of telephones by the directors and employees of the company for non-business purposes and ignoring the fact that the assessee itself has disallowed Rs.42,000/- on this count.

111. The impugned disallowance out of oil and petrol expenses and telephone expenses were made by the Assessing Officer, on adhoc basis. In appeal, CIT(A) has deleted the same and aggrieved by the relief so granted Assessing Officer is in appeal before us.

112. Learned representatives fairly agree that these issues are covered, in favour of the assessee, by order dated 17th July 2009, in assessee's own case for the assessment year 1999-2000, even as learned Departmental Representative dutifully relied upon the orders of the authorities below.

113. We see no reasons to take any other view of the matter than the view so taken by the coordinate bench. Respectfully following the same, we uphold the order of the CIT(A) and decline to interfere in the matter.

114. Ground No. 5 and 6 is also thus dismissed.

115. In ground no. 7, the Assessing Officer has raised the following

grievance:

> ***On the facts and circumstances of the case and in law, the learned CIT(A) has erred in holding that the payments of PF and ESIC amounting to Rs.24,859/- made before filing the return are eligible for deduction without considering the fact that the due dates in the respective Acts for the said payment is 15th and 21st of each month.***

116. There is no dispute that the amounts are paid well before the due date of filing of return of income. In this view of the matter, and respectfully following the stand taken by the coordinate benches in following Hon'ble Supreme Court's judgments in the cases of Vinay Cement Vs CIT (213 CTR 268) and CIT Vs Alom Extrusions Ltd (319 ITR 306), we approve the relief granted by the CIT(A) and decline to interfere in the matter.

117. Ground No. 7 is also dismissed.

118. In ground nos. 8 and 9, the Assessing Officer has raised the following grievances:

8. On the facts and circumstances of the case and in law, the learned CIT(A) has erred in directing not to exclude 90% of the following amounts from the profits eligible for deduction u/s. 80HHC, though the same have no direct or immediate nexus with the export activity of the assessee :

(a) Interest income- Rs.13,81,813/-;-
(b) Sale of Scrap – Rs.1,12,47,951/-;
(c) Foreign Exchange Rate Fluctuation- Rs.16,94,39,293/-.

On the facts and circumstances of the case and in law, the learned CIT(A) has granted relief on the issue of exchange rate difference without appreciating the fact that the gain on exchange difference is nothing but speculation profit and not related to the business of the assessee.

The ld. CIT(A) failed to appreciate that the assessee enters into a forward contract as in this case, the assessee stands to benefit by the

fluctuations in foreign exchange irrespective of the fact whether the trade agreement exists or not.

On the facts and circumstances of the case and in law, the learned CIT(A) has erred in allowing deduction u/s. 80HHC on foreign exchange gains which include gains from forward contract in foreign exchange. The profit on forward contract is not related to export business and profit is earned only by fluctuation in foreign currency on a given date on a forward contract and are therefore independent/speculation receipts not forming part of export turnover.

9. On the facts and circumstances of the case and in law, the learned CIT(A) has erred in directing not to exclude the following amounts from the manufacturing profits eligible for deduction u/s. 80IB, though the same have no direct or immediate nexus with the manufacturing activity of the assessee as per ratio laid down by the Hon'ble Apex Court in the cases CIT –vs.- Sterling Foods (1999) 237 ITR 579 and Pandian Chemicals –vs.- CIT (2003) 262 ITR 278 (SC)

(a) interest income - Rs.13,81,813/-
(b) ***Sales of scrap – Rs.1,12,47,951/-***
(c) ***Foreign Exchange Rate Fluctuation- Rs.16,94,39,293/-.***

119. As far as these grievances are concerned, learned counsel for the assessee conceded the point with regard to sales write off, at item (c) above. Learned representatives also agreed that so far as interest income is concerned, consistent with the stand taken by the coordinate benches in assessee's own case for the earlier assessment years, the netting is required to be done, and that the issue regarding sale of scrap is concerned, the same in covered in favour of the assessee by decisions of the coordinate benches in assessee's own cases. As regards the last point, i.e. exchange rate difference, learned representatives agree that consistent with the stand taken in the earlier years, on similar facts, the matter is required to be remitted to the file of the Assessing Officer for fresh adjudication in the light of Hon'ble jurisdictional High Court's judgment in the case of CIT Vs Amba Impex (282 ITR 144).

120. In view of the above discussions, and consistent with the stand taken for the preceding assessment years, ground no. 8 and 9 are partly allowed in the terms indicated above.

121. In ground no. 10, the grievance raised by the Assessing Officer is as follows:

> ***10. On the facts and circumstances of the case and in law, the learned CIT(A) has erred in directing not to exclude the export benefit of Rs.16,50,80,356/- received by the assessee, from the manufacturing profits eligible for deduction u/s. 80IB of the Act without considering the fact that it has no direct or immediate nexus with the manufacturing activity of the assessee.***

122. So far as this issue is concerned, with the consent of the parties, this issue stands restored to the file of the Assessing Officer for fresh adjudication in the light of Hon'ble Supreme Court's judgment in the case of Topman Exports vs CIT (342 ITR 49).

123. Ground No. 10 is thus allowed for statistical purposes in the terms indicated above.

124. In ground no. 11 and 12, the Assessing Officer has raised the following grievances:

> ***11. On the facts and circumstances of the case and in law, the learned CIT(A) has erred in holding that excise duty and sales will not be included in the total turnover while calculating the deducting u/s. 80HHC of the Act without considering the fact that the issue in question is yet to be decided by the Highest Court of the Land.***
>
> ***12. On the facts and circumstances of the case and in law, the learned CIT(A) has erred in deleting the addition made to the book profit u/s. 115JB in respect of loss of Rs.14,08,476/-***

incurred on Wind Farm Project without appreciating the fact that the profit includes loss and in fact loss are negative profit and hence such loss is to be added while working the book profit u/s. 115JB of the Act.

125. Learned representatives agree that these issues are also covered, in favour of the assessee, by order of a coordinate bench, in assessee's own case for the assessment year 1998-99. A copy of the said order was also placed before us, and is deemed to be attached to and forming part of this order as well.

126. We see no reasons to take any other view of the matter than the view so taken by the coordinate bench in assessee's own case. Respectfully following the same, we approve the conclusions arrived at by the CIT(A) and decline to interfere in the matter.

127. Ground No. 11 and 12 are also dismissed.

128. In ground no. 13, the Assessing Officer has raised the following grievance:

13. On the facts and circumstances of the case and in law, the learned CIT(A) has erred in holding that the additions [i.e. adjustments] to the arm's length price of international transaction relating to interest on loan and relating to interest for excess credit period allowed ought to have been made by taking the interest rate for the purposes of addition, as LIBOR rate, or the American rate of interest.

129. This issue came up for adjudication in immediately preceding assessment year also. Following the stand so taken, and for the detailed reasons set out earlier in this order, this grievance of the Assessing Officer is dismissed as academic.

130. Ground No. 13 is also dismissed.

131. In the result, ITA No. 1762/Ahd/ 2006, being Assessing Officer's appeal against the quantum assessment for the assessment year 2003-04 is partly allowed, in the terms indicated above.

132. The next appeal is ITA No. 3143/Ahd/08, i.e. Assessing Officer's appeal against the CIT(A)'s order deleting penalty imposed on the assessee under section 271(1)(c) of the Income Tax Act, 1961, for the assessment year 2003-04..

133. Grievances raised by the Assessing Officer are as follows:

1. ***On the facts and circumstances of the case and in law, the learned CIT(A) has erred in deleting the penalty of Rs.78,79,705/- without considering fact that same was levied on the upward adjustment made by the TPO regarding non charging of interest on the advances given to associate concerns and subsequently confirmed in the first appeal.***
2. ***On the facts and circumstances of the case and in law, the learned CIT(A) has erred in granting relief to assessee without considering the fact that by not charging interest on advances to sister concerns and claiming interest expenses on the borrowings, assessee has reduced its taxable income for the year and thereby concealed the income.***
3. ***It is, therefore, prayed that the order of the learned CIT(A) be set aside and that the order of the AO be restored.***

134. In view of the fact that, as earlier in the order, the quantum addition itself is deleted, the very foundation for the impugned penalty ceases to hold good in law. The penalty must stand deleted for this short reason alone. Accordingly, we confirm the conclusions arrived at by the CIT(A) and decline to interfere in the matter. Even as we do so, since the related quantum addition itself is deleted, we see no need to address ourselves to the reasoning adopted in the orders of the authorities below.

With these observations, grievances of the Assessing Officer stand rejected.

135. In the result, ITA No. 3143/Ahd/08 is dismissed.

136. To sum up, so far as assessment year 2003-04 is also concerned, while cross appeals filed by the assessee and the Assessing Officer in the quantum assessment are partly allowed in the terms indicated above, the appeal filed by the Assessing Officer against deletion of penalty under section 271(1)(c) by the CIT(A) stands dismissed.

137. We now move on to the assessment year 2004-05.

138. We will first take up the ITA No. 2583/Ahd/ 07, i.e. assessee's appeal against CIT(A)'s order in the matter of quantum assessment proceedings for the assessment year 2004-05.

139. Ground nos. 1 and 2 are general in nature and donot call for any adjudication as such.

140. In ground no. 3 and 4 , the assessee has raised the following grievances:

> ***3. On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in confirming the action of the learned Assistant Commissioner of Income Tax in disallowing Rs.3,58,021/- out of business development expenses pertaining to Vapi-I operations, Rs.3,96,752/- pertaining to Vapi-II operations, Rs.4,37,534/- pertaining to Daman Operations, Rs.7,74,324/- pertaining to Silvassa operations, Rs.2,99,181/- pertaining to EOU operations and Rs.850/- pertaining to Silvassa-II operations. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted***

4. On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in confirming the action of the learned Assistant Commissioner of Income Tax in making addition of Rs.7,263/- out of office expenses pertaining to Daman operations, Rs.27,845/- pertaining to Silvassa operations and Rs.34,682/- pertaining to Vapi-II operations. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.

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141. Learned counsel for the assessee very fairly submits that these issues are covered against the assessee, by Tribunal's orders in assessee's own case, and he would not, therefore, like to press the same. Learned Departmental Representative does not object to this stand.

142. Ground nos. 3 and 4 are thus dismissed.

143. In ground no. 5 and 6 , the assessee has raised the following grievances:

5. On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in confirming the action of the learned Assistant Commissioner of Income Tax of excluding following items of income while granting deduction u/s. 80HHC :-

	Silvassa	***Daman***	***Others***
Income from wind mill	***0***	***0***	***291700***
Commission received	***23002834***	***12997839***	***18209154***
Sales of DEPB and DFRC	***1084301***		***4046665***
Donation refund	***291648***	***164797***	***230870***
Insurance claim	***3468047***	***0***	***117869***
Penalty recovered from parties	***3646***	***2060***	***2886***
Recovery	***0***	***152000***	***5750***

against damages			
Total	***27850476***	***13316696***	***22904894***

The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.

6. On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in confirming the action of the learned Assistant Commissioner of Income Tax of excluding following items of income while granting deduction u/s. 80IB:-

	Daman	***Silvassa***	***Silvassa-II***
Commission received	***12997839***	***23002834***	***25259***
Sales of DEPB and DFRC		***1084301***	***0***
Donation refund	***164797***	***291648***	***320***
Insurance claim	***0***	***3468047***	***0***
Penalty recovered from parties	***2060***	***3646***	***4***
Recovery against damages	***152000***	***0***	***0***
Total	***13316696***	***27850476***	***25583***

The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.

144. So far as the above issues are concerned, as learned representatives agree, that the matter can be restored to the file of the Assessing Officer for fresh decision in the light of the observations made by us dealing with identical issues for preceding assessment years. The assessee will have the liberty to take up such plea as he may deem fit and the AO shall decide the matter afresh after giving a fair and reasonable opportunity of hearing to the assessee, by way of a speaking order and in accordance with the law. We order so.

145. Ground Nos. 5 and 6 are thus allowed for statistical purposes in the terms indicated above.

146. In ground no. 7, the assessee has raised the following grievance:

> ***On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in confirming the action of the learned Assistant Commissioner of Income Tax in disallowing Rs.6,78,501/- out of loss incurred by the appellant company on traded items pertaining to Vapi-I operations, Rs.4,16,218/- pertaining to Daman operations, Rs.24,39,299/- pertaining to Silvassa operations and Rs.2,66,500/- pertaining to EOU operations. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.***

147. As regards this ground of appeal, learned counsel submits that the matter may be remitted to the file of the Assessing Officer so that full details can be furnished by the assessee and the matter be decided in the light of the same. Learned Departmental Representative submits that no useful purpose will be served by this exercise as the assessee has been given sufficient opportunity to establish his case, but he does not seriously oppose the prayer of the assessee.

148. In our considered view, the ends of justice will be met by remitting the matter to the file of the Assessing Officer for fresh adjudication after giving yet another opportunity of hearing to the assessee, in accordance with the law and by dealing with contentions of the assessee in a speaking order. We direct so.

149. Ground no. 7 is thus allowed for statistical purposes in the terms indicated above.

150. In ground no. 8, the assessee has raised the following grievance:

On appreciation of the facts and circumstances of the case and law, the learned Commissioner of Income Tax (Appeals) has erred in upholding the action of the learned Assistant Commissioner of Income Tax in making upward adjustment of Rs.1,94,35,463/- to the total income of the appellant company on account of determining the arm's length price of the international transactions. The action of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and law and deserves to be deleted.

151. In view of the decision on this issue in the immediately preceding assessment years, and for the detailed reasons set out earlier in this order, we uphold the grievance of the assessee in the manner indicated earlier in this order. The observations so made will apply mutatis mutandis for this assessment year as well.

152. Ground no. 8 is thus allowed.

153. In the result, ITA No. 2583/Ahd/07 is partly allowed as indicated above.

154. We now take up ITA No. 2447/Ahd/07, i.e. Assessing Officer's appeal against CIT(A)'s order in the matter of quantum assessment proceedings for the assessment year 2004-05.

155. In ground no. 1, the Assessing Officer has raised the following grievance:

On the facts and circumstances of the case and in law, the learned CIT(A) has erred in deleting the addition made on account of Inter Division Transfer without going into the facts and circumstances of the case.

156. As far as this grievance of the Assessing Officer is concerned, learned representatives fairly agree that this issue is required to be

remitted to the file of the Assessing Officer for fresh adjudication as in the earlier years dealt with by a coordinate bench of this Tribunal, in assessee's own case and vide order dated 17th June 2009. The observations made in this order shall apply mutatis mutandis for this year as well, and the said order will be deemed to be attached to and forming part of this order.

157. Ground No. 1 is thus allowed for statistical purposes in the terms indicated above.

158. In ground no. 2, the Assessing Officer has raised the following grievance:

> ***On the facts and circumstances of the case and in law, the learned CIT(A) has erred in deleting the addition on account of staff welfare expenses amounting to Rs.16,55,452 without appreciating the fact that the assessee failed to explain that the expenditure was incurred wholly, exclusively and necessarily for the business purposes.***

159. So far as this grievance of the Assessing Officer is concerned, it is sufficient to take note of only a few material facts. In the course of the assessment proceedings, the Assessing Officer disallowed a part of staff welfare expenses on the ground that it pertains to tea, coffee, lunch and dinner etc at the workplace and a part of this expenditure is in the nature of entertainment expenses which cannot be allowed as a deduction. In appeal, CIT(A) held that such a disallowance cannot be sustained in appeal as there was no material to come to the conclusion arrived at by the Assessing Officer. The Assessing Officer is aggrieved and is in appeal before us.

160. Having heard the rival contentions and having perused the material on record, we see no reasons to interfere in the matter. There is

no material before us to support the AO's stand that a part of this expenditure is entertainment expenditure in nature. The CIT(A) was thus quite justified in granting the impugned relief and we approve the same.

161. Ground No. 2 is thus dismissed.

162. In ground no. 3, the Assessing Officer has raised the following grievance :

> ***On the facts and circumstances of the case and in law, the learned CIT(A) has erred in deleting the addition on account of foreign travelling expenses amounting to Rs.16,91,138 without appreciating the fact that the assessee failed to substantiate its claim that the expenditure was incurred wholly, exclusively and necessarily for the purposes purpose.***

163. The impugned disallowance out of foreign travel expenses was made by the Assessing Officer, on adhoc basis, at one fifth of the expenses. In appeal, CIT(A) has deleted the same and aggrieved by the relief so granted Assessing Officer is in appeal before us.

164. Learned representatives fairly agree that this issue is covered, in favour of the assessee, by order dated 17th July 2009, in assessee's own case for the assessment year 1999-2000, even as learned Departmental Representative dutifully relied upon the orders of the authorities below.

165. We see no reasons to take any other view of the matter than the view so taken by the coordinate bench. Respectfully following the same, we uphold the order of the CIT(A) and decline to interfere in the matter.

166. Ground No. 3 is thus dismissed.

167. In ground no. 4 and 5, the Assessing Officer has raised the

following grievance:

> ***5. On the facts and circumstances of the case and in law, the learned CIT(A) has erred in deleting the addition of Rs.16,91,138 on account of oil and petrol expenses without considering the fact that the assessee failed to file the log book to establish that the vehicles were used for business purposes and it failed to substantiate its claim that the expenditure was incurred wholly, necessarily an exclusively for the business of the assessee, since part of the disallowance was made by it voluntarily.***
>
> ***6. On the facts and circumstances of the case and in law, the learned CIT(A) has erred in deleting the disallowance of Rs.58,000/- made out of the telephone expenses without considering the fact of possibility of use of telephones by the directors and employees of the company for non-business purposes and ignoring the fact that the assessee itself has disallowed Rs.42,000/- on this count.***

168. The impugned disallowance out of oil and petrol expenses and telephone expenses were made by the Assessing Officer, on adhoc basis. In appeal, CIT(A) has deleted the same and aggrieved by the relief so granted Assessing Officer is in appeal before us.

169. Learned representatives fairly agree that these issues are covered, in favour of the assessee, by order dated 17th July 2009, in assessee's own case for the assessment year 1999-2000, even as learned Departmental Representative dutifully relied upon the orders of the authorities below.

170. We see no reasons to take any other view of the matter than the view so taken by the coordinate bench. Respectfully following the same, we uphold the order of the CIT(A) and decline to interfere in the matter.

171. Ground No. 4 and 5 are also thus dismissed.

172. In ground no. 6, the Assessing Officer has raised the following

grievance:

> ***On the facts and circumstances of the case and in law, the learned CIT(A) has erred in holding that the payments of PF and ESIC amounting to Rs.14,943 made before filing the return are eligible for deduction without considering the fact that the due dates in the respective Acts for the said payment is 15th and 21st of each month.***

173. There is no dispute that the amounts are paid well before the due date of filing of return of income. In this view of the matter, and respectfully following the stand taken by the coordinate benches in following Hon'ble Supreme Court's judgments in the cases of Vinay Cement Vs CIT (213 CTR 268) and CIT Vs Alom Extrusions Ltd (319 ITR 306), we approve the relief granted by the CIT(A) and decline to interfere in the matter.

174. Ground No. 6 is also dismissed.

177. In ground nos. 7 and 8, following grievances have been raised:

> ***7. On the facts and circumstances of the case and in law, the learned CIT(A) has erred in directing not to exclude 90% the following amounts from the profits eligible for deduction u/s. 80HHC, though the same have no direct or immediate nexus with the export activity of the assessee :***
>
> ***(a) Interest income - Rs.2,45,02,175/-;***
> ***(b) Sales of Scrap – Rs.1,43,88,881/-;***
> ***(c) Reversal of Provisions – Rs.63,44,192/-;***
> ***(d) Telephone refund – Rs.6,329/-;***
> ***(e) Recovery charges from shareholders – Rs.3,167/-***
> ***(f) Exchange rate difference - Rs.10,49,59,937/-.***

On the facts and circumstances of the case and in law, the learned CIT(A) has erred in holding that the income from interest of Rs.2,45,02,175/- is eligible for deduction u/s. 80HHC without considering the fact that it has no direct or immediate nexus with the export activity of the assessee

On the facts and circumstances of the case and in law, the learned CIT(A) has erred in allowing the benefit of 'netting out' without considering the fact that there are contradictory decisions on the issue of the various Tribunals and Courts.

On the facts and circumstances of the case and in law, the learned CIT(A) has erred in directing not to exclude exchange rate difference of Rs.10,49,59,937/- from the profits eligible for deduction u/s. 80HHC and 80IB, though the same have no direct or immediate nexus with the export/manufacturing activity of the assessee.

On the facts and circumstances of the case and in law, the learned CIT(A) has granted relief on the issue of exchange rate difference without appreciating fact that gain on exchange difference is nothing but speculation profit and not related to business of the assessee.

The ld. CIT(A) failed to appreciate that assessee enters into a forward contract as in this case, assessee stands to benefit by the fluctuations in foreign exchange irrespective of fact whether the trade agreement exists or not.

On the facts and circumstances of the case and in law, the learned CIT(A) has erred in allowing deduction u/s. 80HHC on foreign exchange gains which include gains from forward contract in foreign exchange. The profit on forward contract is not related to export business and profit is earned only by fluctuation in foreign currency on a given date on a forward contract and are therefore independent/speculation receipts not forming part of export turnover.

8. On the facts and circumstances of the case and in law, the learned CIT(A) has erred in directing not to exclude the following amounts from the manufacturing profits eligible for deduction u/s. 80IB, though the same have no direct or immediate nexus with the manufacturing activity of the assessee as per ratio laid down by the Hon'ble Apex Court in the cases CIT –vs.- Sterling Foods (1999) 237 ITR 579 and Pandian Chemicals –vs.- CXIT (2003) 262 ITR 278 (SC)

- ***(a) interest income - Rs.2,45,02,175/-***
- ***(b) Sales of scrap – Rs.1,43,88,881/-***
- ***(c) Reversal of provisions –Rs.63,44,192/-;***
- ***(d) Telephone refund – Rs.6,329/-;***
- ***(e) Recovery of charges from shareholders- Rs.3,167/-;***
- ***(f) Exchange Rate Difference - Rs.10,49,59,937/-.***

178. So far as the above issues are concerned, as learned representatives agree, that the matter can be restored to the file of the Assessing Officer for fresh decision in the light of the observations made by us while dealing with identical issues for preceding assessment years. The assessee will have the liberty to take up such plea as he may deem fit and the AO shall decide the matter afresh after giving a fair and reasonable opportunity of hearing to the assessee, by way of a speaking order and in accordance with the law. We order so.

179. Ground nos. 7 and 8 are thus allowed for statistical purposes in the terms indicated above.

180. In ground no. 9, the Assessing Officer has raised the following grievance:

> ***9. On the facts and circumstances of the case and in law, the learned CIT(A) has erred in directing not to exclude the export benefit receivable of Rs.1,89,32,354/- received by the assessee, from the manufacturing profits eligible for deduction u/s. 80IB of the Act without considering the fact that it has no direct or immediate nexus with the manufacturing activity of the assessee.***

181. So far as this ground of appeal is concerned, learned representatives agree that this issue can be restored to the file of the Assessing Officer so as the matter can be decided in the light of Topman Exports decision (supra) on the question of sale of export benefits, and in the light of examining nexus of insurance receipts with the business activity.

182. Ground no. 9 is thus allowed for statistical purposes.

183. In ground no. 10, the grievance raised is as follows:

10. On the facts and circumstances of the case and in law, the learned CIT(A) has erred in holding that the excise duty and sales will not be included in the total turnover while calculating the deduction u/s. 80HHC of the Act without considering the fact that the issue in question is yet to be decided by the Highest Court of the Land.

On the facts and circumstances of the case and in law, the ld. CIT(A) has erred in relying the decision of M/s. Sudarshan Chemicals while giving relief to assessee without considering the fact that the said decision was delivered before the insertion of provisions of section 145A of the Act as per which valuation of purchase and sale has to be made after adding tax, duty, cess or fee etc.

184. Learned representatives agree that these issues are also covered, in favour of the assessee, by order of a coordinate bench, in assessee's own case for the assessment year 1998-99. A copy of the said order was also placed before us, and is deemed to be attached to and forming part of this order as well.

185. We see no reasons to take any other view of the matter than the view so taken by the coordinate bench in assessee's own case. Respectfully following the same, we approve the conclusions arrived at by the CIT(A) and decline to interfere in the matter.

186. Ground No. 10 is also dismissed.

187. In ground no. 11, the Assessing Officer has raised the following grievance:

On the facts and circumstances of the case and in law, the learned CIT(A) has erred in deleting the addition made to the book profit u/s. 115JB in respect of loss of Rs.17,08,344/- incurred on Wind Farm Project without appreciating the fact that profit includes loss and in fact loss are negative profit and

hence such loss is to be added while working the book profit u/s. 115JB of the Act.

188. Learned representatives agree that this issue is also covered, in favour of the assessee, by order of a coordinate bench, in assessee's own case for the assessment year 1998-99. A copy of the said order was also placed before us, and is deemed to be attached to and forming part of this order as well.

189. We see no reasons to take any other view of the matter than the view so taken by the coordinate bench in assessee's own case. Respectfully following the same, we approve the conclusions arrived at by the CIT(A) and decline to interfere in the matter.

190. Ground No. 11 is thus also dismissed.

191. In ground no. 11, the Assessing Officer has raised the following grievance:

On the facts and circumstances of the case and in law, the learned CIT(A) has erred in holding that the additions (i.e. adjustments) to the arm's length price of international transaction relating to interest on loan and relating to interest for excess credit period allowed ought to have been made by taking the interest rate for the purposes of addition, as LIBOR rate, or the American rate of interest.

192. This issue came up for adjudication in immediately preceding assessment year also. Following the stand so taken, and for the detailed reasons set out earlier in this order, this grievance of the Assessing Officer is dismissed as academic.

193. Ground No. 12 is also dismissed.

194. In the result, ITA No. 2447/Ahd/ 2007, being Assessing Officer's appeal against the quantum assessment for the assessment year 2004-05 is partly allowed, in the terms indicated above.

195. The next appeal is ITA No. 940/Ahd/10, i.e. Assessing Officer's appeal against the CIT(A)'s order deleting penalty imposed on the assessee under section 271(1)(c) of the Income Tax Act, 1961, for the assessment year 2004-05.

196. Grievances raised by the Assessing Officer in this appeal are as follows:

1. ***On the facts and circumstances of the case and in law, the learned CIT(A) has erred in deleting the levy of penalty of Rs.69,72,472/- u/s.271(1)(c) of the Act on addition made of Rs.1,94,35,463/- on account of upward adjustment to the income of the assessee company on account of determining the arm's length price of the international transactions as per order u/s.92CA(3) by the Addl. CIT(transfer pricing-1) Mumbai.***

2. ***It is, therefore, prayed that the order of the learned CIT(A) be set aside and that the order of the AO be restored.***

3. ***The appellant craves leave to add, alter or amend any grounds of appeal.***

197. In view of the fact that, as earlier in the order, the quantum addition itself is deleted, the very foundation for the impugned penalty ceases to hold good in law. The penalty must stand deleted for this short reason alone. Accordingly, we confirm the conclusions arrived at by the CIT(A) and decline to interfere in the matter.

198. Even as we do so, since the related quantum addition itself is deleted, we see no need to address ourselves to the reasoning adopted in

the orders of the authorities below.

199. With these observations, grievances of the Assessing Officer stand rejected.

200. In the result, ITA No. 940/Ahd/10 is dismissed.

201. To sum up, so far as assessment year 2004-05 is also concerned, while cross appeals filed by the assessee and the Assessing Officer in the quantum assessment are partly allowed in the terms indicated above, the appeal filed by the Assessing Officer against deletion of penalty under section 271(1)(c) by the CIT(A) stands dismissed. Pronounced in the open court today on 6th day of August, 2013.

Sd/xx *Sd/xx*
(Kul Bharat) **(Pramod Kumar)**
Judicial Member Accountant Member
Ahmedabad: 6th day of August , 2013.

Copy forwarded to :

1. *The appellant*
2. *The respondent*
3. *Commissioner , Ahmedabad*
4. *CIT(A) , Ahmedabad*
5. *Departmental Representative, bench, Ahmedabad*
6. *Guard File*

True Copy

By Order etc.

Assistant Registrar