

**IN THE INCOME TAX APPELLATE TRIBUNAL
BENCH 'F' DELHI**

**ITA No.4084 (Del) of 2010
Assessment Year: 2007-2008**

**M/s PINE PACKAGING PVT LTD
B-6, 25/1, SAFDARJUNG ENCLAVE
NEW DELHI
PAN NO:AAACP1832G**

Vs

**INCOME TAX OFFICER
WARD-14(2), NEW DELHI**

R P Tolani, JM and K D Ranjan, AM

Dated: January 14, 2011

Appellants Rep by: Shri Pradeep Dinodia, F C A & Shri R K Kapoor, CA

Respondent Rep by: Shri H K Lal, Sr. DR

ORDER

Per: K D Ranjan:

This appeal by the assessee for assessment year 2007-08 arises out of order of the Id. CIT (Appeals)-XVII, New Delhi.

2. The grounds of appeal raised by the assessee, read as under :-

" 1. That the Id. CIT (Appeals) has grossly erred in law and on facts and in the circumstances of the appellant case in confirming the addition of Rs. 1,05,09,877/- on account of claim under section 80-IC of the Income-tax Act made by the appellant;

2. That the Id. CIT (Appeals) has grossly erred in misunderstanding and wrongly applying the provisions of law for the purposes of section 80-IC of the Income-tax Act made by the appellant;

3. That the Id. CIT (Appeals) ought to have appreciated that the maximum amount of disallowance of claim under section 80-IC could not exceed the amount of claim made by the appellant under that section amounting to Rs.10,79,096/-;

4. That the confirmation of the order of the assessing officer by the CIT (Appeals) in disallowing a sum of Rs.1,05,09,877/- as against the actual claim of Rs.10,79,096/- is based on misapplication of mind by the CIT (Appeals) and grossly wrong in law and on facts;

5. That the CIT (Appeals) ought to have held that the sum of Rs.1,05,09,877/- has been derived from the business of manufacturing activities and therefore was eligible for computing the claim under section 80-IC of the Income-tax Act;

6. That the reliance by the CIT (Appeals) on the decision of the Hon'ble Supreme Court in the case of Liberty India Ltd. Vs. CIT is erroneous and in fact, the decision of the Supreme Court should have been interpreted in favour of the assessee;

7. That the Id. CIT (Appeals) has grossly erred in upholding the charging of interest under section 234-B of the Income-tax Act. "

3. The first issue for consideration relates to confirming the addition of Rs.1,05,09,877/- on account of claim under section 80-IC of the I. T. Act, 1961. The facts of the case stated in brief are that the assessee during the relevant previous year was engaged in the business of manufacturing plastic bottles, caps and closures for Hindustan Liver Ltd. [HLL] from its factory situated at Plot No. 6, Sector 1-A, IIE Ranipur, Haridwar. During the year under consideration made the assessee sales of Rs.9,81,75,513/- and earned misc. income of Rs.1,78,461/- and net profit was shown at Rs.86,95,402/-, which was adjusted against brought forward un-absorbed depreciation of Rs.45,26,020/- and balance amount was claimed as deduction under section 80- IC of the Act. The total receipts of Rs.9,81,75,513/- includes misc. income of Rs.1,05,09,877/- on account of standing charges paid by HLL. The AO required the assessee to explain as to why deduction under section 80-IC of the Act should be allowed on this misc. income of Rs.1,05,09,877/-. It was explained by the

assessee that M/s. Hindustan Liver Ltd., Mumbai, [HLL] entered into agreement with the assessee on 23rd June, 2004 for setting up a manufacturing unit at Haridwar to undertake the manufacture / processing and packaging and sale of plastic bottles, caps and enclosures etc. to HLL as per the specifications prescribed by the company. M/s. Pine Packaging Pvt. Ltd. pursuant to agreement with HLL set up a manufacturing unit at Haridwar. As per agreement the assessee was to manufacture the products on the normatic fixed level fixed by HLL and in the eventuality of downward change of volume and production levels based on HLL the assessee was to be compensated for idle time and conversion cost, which remained un-covered. Considering the business model, HLL agreed to pay in such eventuality standing charges equal to salaries and wages, depreciation, interest on term loan, 50 per cent of return of equity, fixed portion of repairs and maintenance, insurance, rent, if any. In case of over-production from normatic production the charges payable would be revised down-ward. During the year under consideration the assessee received Rs.1,05,09,877/- on account of standing charges on which deduction under section 80-IC of the Act has been claimed.

4. As regards eligibility of deduction under section 80-IC it was submitted by the assessee that the standing charges are mechanism of balancing the production cost in relation to normatic production agreed by HLL. Since the standing charges were payable only when sale decreased from normatic level and selling prices reduced when sale increased than the normatic production. Therefore, the standing charges are paid under a mechanism to increase and decrease the selling price to cover the fixed expenses. Hence, the nature of standing charges could be said as part of selling price of the product manufactured to cover the fixed cost incurred by the company while there was drop in normatic production volume. It was also submitted that standing charges were in the nature of reimbursement of fixed cost of production in relation to unit which could not be recovered due to drop in production volume from stipulated normatic level and therefore, the amount received on this account amounts to reduction of expenses and instead of showing in the income side, it could have been credited to respective expenses account, but on the basis of accounting principle and practice it has been shown on the income side in the profit and loss account. Therefore, the assessee was entitled to deduction under section 80-IC of the Act. The AO was, however, of the opinion that standing charges were not on account of sale, but were on account of compensation for less than minimum guarantee of buying goods from eligible undertaking. Therefore, the profit belonged

to category of ancillary profits which could not be treated as sale consideration. The AO relied on the decision of Hon'ble Supreme Court in the case of *Liberty India - 317 ITR 218 (SC)* for the proposition that the profit derived from undertaking would mean the profit of first degree as against the profits attributable to industrial undertaking. Accordingly, the assessee was not entitled for deduction under section 80-IC of the Act.

5. On appeal it was submitted that the assessee was entitled for deduction under section 80IC of the Act. The assessee company was engaged in no other activity then running the production facilities at Haridwar, the profits from which were eligible under section 80-IC. The whole of the income received by the assessee was wholly and exclusively derived from manufacturing operations set up at Haridwar. It was submitted that even if the AO treats the receipts by the assessee company of Rs.1,05,09,877/- as not eligible for deduction under section 80-IC, at the best he could disallow the deduction at Rs.10,79,096/- which was claimed by the assessee in the return of income. The AO has mistakenly added the whole amount of standing charges to the taxable income without realizing that the same has been included in the gross total income of Rs.86,95,402/-. Therefore, it amounted to double taxation of Rs.94,30,731/-. The Id. CIT (Appeals) after considering the various decisions cited by the assessee held that the assessee was not entitled for deduction under section 80-IC on the ground that standing charges received by the assessee were not derived from the first degree income, which is directly derived from manufacturing. While confirming the order, he held as under :-

" 4. I have carefully considered the submission made by the appellant and perused the assessment order passed by the AO. It is seen that the receipt of standing charges received by the appellant from Hindustan Lever Limited is on account of compensation for less than minimum guarantee of buying of goods from the eligible undertaking. The profits belong to the category of ancillary profit of such undertaking. The standing charges cannot be treated as sale consideration and are treated as separate items of income and are accounted for accordingly in the Profit and Loss account. Therefore, the profit belongs to the category of ancillary profit and not a direct profit from the manufacturing which is envisaged under section 80-IC. In the case under consideration it is an admitted fact that the appellant was receiving standing charges from Hindustan Lever Ltd. which are in the nature of compensation for "idle time" and "conversion cost". Thus, the payment received on account of

standing charges by no stretch of imagination can be said to be derived from manufacturing. The AO has given cogent reason for making the disallowance. The Hon'ble Apex court in the case of Liberty India Vs. CIT (supra) has held that in order to be eligible for deduction under section 80-IA / 80-IB, there has to be first degree income which is directly derived from the manufacturing. The ITAT Jodhpur Bench in the case of Income Tax Officer Vs. VJ Home (P) Ltd. (supra) has held that any incentive cannot be treated as having been derived from eligible undertaking. The decision in the case of CIT Vs. Arvind Construstion Ltd. and CIT Vs. Sportking India Ltd. (supra) cited by the Id. AR are not applicable to the facts of the appellant's case as they were decided on altogether different facts. In view of the facts of the case and legal position on the issue, I hold that the AO was fully justified in disallowing the claim of the appellant under section 80-IC of the Act. Therefore, I confirm the addition made by the AO. These grounds of appeals are rejected. "

6. Before us, the Id. AR of the assessee submitted that the standing charges received at Rs.1,05,09,877/- were in respect of compensation on account of idle time of the machinery. The selling price of the product manufactured by the assessee is determined in terms of cost model. It was also submitted that the assessee is a captive unit of HLL. Therefore, whenever the machinery was not used for the manufacturing purposes, HLL had agreed to reimburse the salary and wage, interest on term loan, 50 per cent return on equity, fixed portion of repairs and maintenance, insurance, rent in the form of standing charges. The money was received by the assessee from its customer, as per the agreement already signed at the time of commencement of production and, therefore, the payments received are wholly and exclusively related to the actual production of the assessee, which is based on orders received from the customers. Therefore, whatever standing charges have been received are wholly and exclusively derived from the manufacturing operations and are fully eligible for deduction under section 80-IC of the Act. He submitted that standing charges are in the nature of first degree income accruing to the assessee from the buyers based on price fixation of products manufactured and sold by the assessee and is nothing, but compensation of expenses which are incurred for running the production facility. Therefore, it has been pleaded that the assessee was entitled for deduction under section 80-IC. On the other hand, the Id. Sr. DR submitted that standing charges are not in the nature of first degree income, but are in the nature of ancillary profits and, therefore, deduction under section 80-IC is not allowable.

7. We have heard both the parties and gone through the material available on record. Under section 80-IC where the gross total income of an assessee includes any profits and gains derived by an undertaking or an enterprise from any business referred to in sub section (2) the assessee will be eligible for deduction from such profits and gains to the extent specified in sub section (3) of section 80-IC of the Act. The contention of the assessee is that standing charges received are in the nature of first degree income and, therefore, in view of decision of Hon'ble Supreme Court in the case of Liberty India (supra) the assessee is eligible for deduction under section 80-IC of the Act. There is no dispute that the assessee is eligible for deduction under section 80-IC. The only dispute is whether the standing charges have been derived from any business referred to in sub section (2) of section 80-IC. Sub section (2) applies to any undertaking or enterprise, which has begun to manufacture or produce any article or thing, not being any article or thing specified in Thirteenth Schedule or which manufactures or produces any article or thing, not being any article or thing specified in the said Schedule and undertakes substantial expansion during the period specified in sub-clauses (i), (ii) and (iii) of clause (a) of sub section (2) of section 80-IC of the Act. Clause (b) of sub section (2) applies to industrial undertaking or enterprise, which has begun or begins to manufacture or produce any article or thing specified in Fourteenth Schedule or commences any operation specified in Fourteenth Schedule and undertake substantial expansion during the period which has been specified in subclause (i), (ii) and (iii) of clause (b) of section 80-IC(2) of the Act. On plain reading of sub section (2) it is clear that deduction under section 80-IC will be available in respect of any profits and gains derived from manufacture or production of article or thing, which is eligible for deduction under section 80-IC of the Act. Therefore, the income should be derived from industrial undertaking from manufacturing or production activities. In the case of assessee, the standing charges have been received as idle charges including return on capital. They represent the reimbursement of certain expenses which cannot be treated as derived from the manufacturing of or production of a article or thing. Therefore, the standing charges which are received by the assessee for compensation on account of idle charges cannot be treated as income derived from industrial undertaking from manufacture or production of a article or thing on simple reason that they are reimbursement of expenses, which the assessee has to incur being a captive unit of HLL and could not manufacture the products for others. The standing charges are received because of lower product demands from HLL though

the same have been paid under the agreement to compensate the assessee in such eventualities. Thus the standing charges cannot be treated as derived from manufacturing activities since it has no nexus between the goods manufactured or produced with the profits derived. The standing charges at the best can be treated as attributable to industrial undertaking.

8. Hon'ble Supreme Court in the case of *Pandian Chemicals Ltd. Vs. CIT - 262 ITR 278 (SC)* has held that the words "derived" in section 80-HH of Income Tax Act must be understood as something which has a direct and immediate nexus with the assessee's industrial undertaking. Although electricity may be required for the purpose of industrial undertaking, the deposit required for its supply is a step removed from the business of industrial undertaking. It was held by the Hon'ble court that the interest derived by the industrial undertaking of the assessee on deposits made with the Electricity Board for supply of electricity for running the industrial undertaking could not be said to flow directly from the industrial undertaking itself and was not profit or gains derived by undertaking for the purpose of special deduction under section 80-HH of the Act.

9. In the case of *Liberty India Vs. CIT (supra)* Hon'ble Supreme Court held that section 80-IB provides for allowing of deduction in respect of profits and gains derived from eligible business. The connotation of words "derived from" is narrower as compared to that of words "attributable to". By using the expression "derived from" Parliament intended to cover sources not beyond the first degree.

10. Applying the ratio of decisions of Hon'ble Supreme Court referred to above to present case we find that the standing charges received by the assessee are reimbursement of expenses incurred by the assessee during idle period and, therefore, it cannot be said to have been derived from manufacture of an article or a thing of eligible business carried on by the industrial undertaking. The standing charges are in the nature of ancillary profits, which at the best can be treated as attributable to the business of industrial undertaking. Respectfully following the precedents, it is held that standing charges will not be eligible for deduction under section 80-IC of the Act. Accordingly, we do not find any infirmity in the order passed by the Id. CIT (A) confirming the disallowance.

11. In the result, the appeal filed by the assessee is dismissed.

(Order pronounced in the open court today on 14.1.2011.)