

**IN THE INCOME TAX APPELLATE TRIBUNAL
BENCH 'B' BANGALORE**

**ITA No.417/Bang/2010
Assessment Year: 2004-2005**

**SAMI LABS LTD
19/1 & 19/2, 1 ST MAIN
2 ND PHASE, PEENYA INDUSTRIAL AREA
BANGALORE-560058**

Vs

**DEPUTY COMMISSIONER OF INCOME TAX
CIRCLE-12(3), BANGALORE**

George George K, JM and A Mohan Alankamony, AM

Dated: February 25, 2011

ORDER

Per: A Mohan Alankamony:

This appeal instituted by the assessee company is directed against the appellate order of the Ld. CIT (A)-III, Bangalore in ITA No: 283/C-12(3)/ CIT(A)-III/BNG/06-07 dated: 30.12.2009 for the assessment year 2004-05.

2. The assessee company ('the assessee' in short) had raised ten grounds in an illustrative and exhaustive manner. Ground Nos: 1 and 10 being general in nature, they have become non-consequential. The issues raised in the remaining grounds are reformulated, for the sake of clarity, in a concise manner, as under:

(1) that the CIT (A) had erred in concluding that Kunigal Unit was not eligible for deduction u/s 10-B of the Act as it had not satisfied one of the conditions laid down in s.10B(2)(iii) of the Act;

(2) that the CIT (A) had erred in disallowing cultivation expenses of Rs.90.64 lakhs on the ground that those expenses were in fact agricultural expenses and were in the nature of losses from agricultural operation which were to be carried forward for set off; &

- alternatively, if the disallowance of cultivation expenses were to be sustained, proportionate higher deduction u/s 10B of the Act ought to have to be allowed.

3. Briefly, the assessee being in the business of manufacture and export of standardized herbal extracts and manufacture of fine chemicals, cosmeceuticals etc., had furnished its income, admitting a loss of Rs.3.43 crores after claiming exemption u/s 10-B of the Act at Rs.7.10 crores.

3.1. While concluding the assessment, the AO had disallowed the exemption claim of Rs.3.44 crores made u/s 10B of the Act in respect of Kunigal Unit and also cultivation expenses of Rs.90.64 lakhs for the reasons recorded in his impugned order under challenge.

4. Aggrieved, the assessee took up the issues with the CIT (A) for re-dressal. After considering the assessee's contentions as well as the reasoning of the AO, the Ld. CIT (A) had observed that –

I. In respect of claim of deduction u/s 10-B with regard to Kunigal Unit :

In conformity with the finding of the Hon'ble Bench in ITA Nos: 3770/B/2004 & 484/B/2005 for the assessment year 2001-02 and 2002-03 respectively in the assessee's own case, the benefit u/s 10-B of the Act claimed to the extent of Rs.3.44 crores was denied.

II. Cultivation expenses of Rs.90.64 lakhs :

After due consideration of the assessee's submissions as well as the Board's Circular No.6/2007 dated: 11.10.2007 on which the assessee had placed its faith, the CIT (A) opined that –

“(on Page 6) in the context of the appellant, I note that this is one of the contract cultivation as they have entered into agreements with various farmers from whom they have promised to purchase Coleus roots at an agreed price. They have also stated in the agreement that in cases where seedlings are supplied by them, it will be recovered @ Rs.2200 for 22000 seedlings. The company has also agreed to give them advance of Rs.1500/- which is also to be recovered from the purchases to be made from them by way of coleus roots. Thus, it can be seen that the company was carrying on contract cultivation activity but the recoveries against seedlings which is by way of agricultural income are probably adjusted against the purchase cost and not netted from the agricultural expenses. In fact, this is agricultural income which ought to have been netted off against agricultural expenses. Hence, I direct the AO to verify the same and if found correct, to reduce the disallowance to the extent of recovery made and reduce the same from the cost of purchases. The rest of the losses from agricultural operations may be carried forward to set off against profits from agricultural operations, if any, in the future.

The CBDT Circular Accordingly, I hold that the disallowance of Rs.90,64,692/- as agricultural expenses is to be upheld subject to the modification of recovery, if any, from the contract farmers which has been netted off against purchases made by them.....”

5. Agitated, the assessee has come up with the present appeal. During the course of hearing, the forceful submissions made by the Ld. A R are summarized as under:

- the authorities below have erred in coming to the conclusion that Kunigal Unit was not eligible for deduction u/s 10-B on the ground that it had not satisfied one of the basic conditions set out in s.10B(2)(iii) as the plant and machinery acquired to the tune of Rs.5.2 crores were old machineries which were already put to use;

- in the case of the assessee, a new undertaking had come into existence with more than 80% newly acquired plant and machinery and, thus, satisfies the test prescribed by the Hon'ble Madras High court in the case of *CIT v. Gopal Plastics Private Limited* - 215 ITR 136 (Mad);

- the authorities below erred in disallowing the cultivation expenses of Rs.90.64 lakhs which were in fact agricultural expenses and were in the nature of losses from agricultural operations, if any, in future;

- that the assessee was engaged in the business of manufacture and export of herbal products and, thus cultivation expenses were incurred as an integral part of the business; that the main purpose of cultivation was to induce farmers to grow medicinal plants and for assessee's own research and development activities for finding new varieties of medicinal plants and arriving at acceptable stands of cultivation by adopting different combination of methods and systems in order to make large scale cultivation of such herbs an economically viable proposition;

- that the assessee was not earning any agricultural income from such cultivation since it was not selling the agricultural produce as the same was being used in its research and development activities and as a raw material for producing industrial products, that though there was an intention to supply the seedlings from its nursery to farmers who were on contract with the assessee to the farmers @ 10ps per seedling which was to be recovered at the time of purchase of coleus roots from them, after they have grown them using those seedlings, the assessee was not able to make any such recovery since it was not able to generate sufficient quantities of coleus in its farms and had to resort to large scale purchase of coleus seedlings from other farmers; that on the basis of representations from the farmers and also considering commercial expediency, no recovery was effected from the farmers;

- that the assessee had incurred cultivation expenses for getting inputs required for carrying on its business activities where the end products were not agricultural produce; that the expenditure incurred was wholly and exclusively for the purpose of the business out of commercial expediency and, hence, ought to have been allowed in full

- Relies on Board's Circular No.6/2007 dated: 11.10.2007;

- During the previous year corresponding to the AY under dispute, the assessee had incurred expenditure to carry on cultivation on its own in order to develop proper standards which could then be given to farmers for inducing them to take up large scale cultivation of the herb, that the assessee had commercialized the project in the subsequent years when farmers took up large scale cultivation of this herb for sale to the assessee; that the expenditure incurred during the period under challenge, was in the normal course of business for entering into a new produce;

- Alternatively, if the disallowance of cultivation expenses were to be sustained, higher deduction u/s 10B of the Act is to be allowed proportionately; that due to upholding the disallowance of the claim of the assessee by the CIT (A), the total income of the assessee had increased to that extent, however, such increased income was not considered while determining the exemption eligible u/s 10B in respect of Nelamangala Unit for which deduction was allowed.

5.1. To reinforce his argument, the Ld. AR had furnished a paper book containing 1 – 35 pages which consists of inter alia copies of (i) Tribunal's orders; (ii) sample lease agreement; (iii) Board's Circular No.6/2007 etc.

5.2. On her part, the Ld. D R was emphatic in her urge that the AO had analyzed the issues in depth and also extensively quoting various judicial pronouncements including that of the Hon'ble Tribunal's findings in the assessee's own case for the earlier years and came to the conclusion in a judicious manner which has been rightly ratified by the first appellate authority. It was, therefore, advocated that the findings of the Ld. CIT (A) require to be sustained in toto.

6. We have duly considered the rival submissions, attentively perused the relevant case records and also the evidences produced during the course of hearing by the Ld. A R in the shape of a paper book.

6.1. With regard to the assessee's canvassing for claim of deduction u/s 10B of the Act in respect of Kunigal Unit, we would like to recall that an identical issue had cropped up in the earlier assessment years in the case of the assessee before the Hon'ble Bench, specifically, for the AYs 2001-02 & 2002-03 and after perusing the rival contentions, the Hon'ble Bench was very specific in its endeavour that –

" 5. After hearing both the sides, we find force in the submission made by the learned DR. The Madras High Court in the case of Gopal Plastics (supra) has held that even at subsequent stage, after the formation of the export oriented undertaking, some more new machineries which were not used earlier are introduced. In that event, it will be deemed that the requirement of law was satisfied. Similar view was taken by the Gujarat High Court in the case of Satellite Engineering Ltd., (supra). The jurisdictional High Court in the case of Nippon Electronics (supra) respectfully disagreed with the aforesaid decision. The Hon'ble High Court was considering the eligibility of exemption under section 80J of the Act. Under section 80J(4)(ii), a criteria was laid down that the undertaking must not have been formed by transfer of machinery or plant previously used for any purpose to the new business. In that case, the Hon'ble High Court held that the eligibility criteria has to be seen in the first year itself when the undertaking was formed and whether it was entitled for relief under section 80J of the Act. Subsequent fulfillment of criteria by investment in new machineries will not be treated as sufficient compliance.

6. In view of the afore said circumstances, we find that a substantial portion of machineries were utilized in the eligible undertaking which were used earlier. Therefore, we do not find any reason to take a different view. Hence, this ground of appeal is rejected."

6.2. Yet again, the Hon'ble Bench, while considering the assessee's plea for the subsequent A.Y in ITA NO: 1036(BNG)/08 dated: 31.12.2008 on a similar issue, had observed thus –

"5. We have heard the rival contentions and perused the material available on record. On our careful perusal of the facts and circumstances as per the contention of the learned counsel, the issue of denial of exemption u/s 10-B has been considered by the authorities below on the basis of the decision of the Tribunal in

assessee's own case for the earlier year against which no substantive material has been brought on record, therefore requires no further interference..... "

6.3. In conformity with the findings of the Hon'ble Bench cited supra on an identical issue, we are of the considered view that the authorities below were justified in denying the assessee's claim on this score.

7. In respect of the assessee's claim for allowance of cultivation expenses of Rs.90.64 lakhs which has been denied by the first appellate authority, we have scrupulously perused the submission of the assessee as well as the reasoning of the authorities below for having turned down the assessee's plea.

7.1. The pleading before the AO was that it had to incur expenses for cultivation of the farmers on trial basis and on its completion, the assessee will procure the produces from the farmers on payments. On a perusal of the lease deeds [the assessee had entered into with farmers for rising of herbal plants], the AO recorded that the farmers were required to sell their herbal plants to the assessee and the assessee had undertaken to purchase the same on cost. Thus, the AO's was of the view that the farmers, without incurring any expenditure on cultivation, were selling their produces to the assessee on a price, and, thus, he opined that the assessee was not required to incur such expenses on behalf of the farmers and, accordingly, disallowed the assessee's claim.

7.2. On his part, the Id. CIT(A) had arrived at a conclusion that the assessee was carrying on contract cultivation activity, but, the recoveries against the seedlings supplied earlier by the assessee were probably adjusted against the purchase cost of herbal plants and were not netted from the agricultural expenses. In a nutshell, he upheld the disallowance on the claim of agricultural expenses with a rider to reduce the disallowance to the extent of recovery made on the cost of seedlings supplied to the farmers (and also reduce the same from the cost of purchases).

7.3. On a close scrutiny of the facts and circumstance of the issue, it emerges that the coleus has been a rare herbal plant which commends precious value in medicinal fraternity for research. The assessee has been in the business of manufacture and export of herbal produces including that of coleus. To maximize the production and sale of herbal extracts, the assessee had to incur certain expenditure on cultivation activities for the development of coleus. According to the assessee, the coleus plant was grown in the wild and vast research was required to make a commercial cultivation of this plant. To cultivate this rare plant and to make a successful venture, the assessee had to undertake farm trials to optimize in different fields, such as (i) optimization of the right season for cultivation, (ii) standardization of the right fertilizer application, (iii) optimization of the right soil conditions, (iv) use of various organic fertilizers, (v) use of bio-controls and other control measures for disease control. However, the exercise done by the assessee during the period under consideration to maximize its yield did not result in a desired effect. In order to promote the cultivation of coleus, the farmers were roped in to cultivate this rare herbal plant and to encourage them to opt for this crop, the assessee had to incur expenditure for –

(i) supply of planting materials to the farmers free of cost;

(ii) supply of farm inputs free of cost; &

(iii) also arranging payments to them etc.,

To propagate its intention to supply seedlings from its nursery to other farmers, it had perhaps entered into agreements and supplied coleus seedlings to the farmers with a condition to recover the cost of coleus seedling at 10ps per seedling at the harvest time. In reality, the assessee could not be able to achieve its desire of generating sufficient quantities of coleus, in stead; it had rather gone in purchase spree of coleus seedlings in a large scale from other farmers.

7.4. Considering the submission of the assessee and also looking into the facts of the issue, we are of the considered view that there is force in the contention of the assessee that it had not generated any agricultural income out of this venture and as a matter of fact, the assessee had not engaged any agricultural activity, but, for cultivation of coleus plants to facilitate its business and due to commercial expediency, it had incurred cultivation expenses to the tune of Rs.90.64 lakhs. We have also perused the details of direct expenses incurred by the assessee under cultivation expenses.

7.5. In this connection, we would like to impress that the concept of Circular No.6/2007 dated: 11.10.2007 of the Board is very much applicable to the facts of the issue on hand. It has been clarified by the Board in its circular cited supra that *"2.....These expenses are incurred by the Sugar Mills for ensuring an adequate and sustained supply of freshly cut sugarcane that is an essential input for the continuous running of such mills. These expenses are, therefore, incurred for a commercial expediency and are prima facie wholly and exclusively for the purpose of business. Such expenses are, therefore, allowable....."*

7.6. Like Sugar Mills, the present assessee had to incur cultivation expenses to ensure adequate and steady supply of coleus plants from the farmers which were an essential input for the continuous processing in research and development activities of the assessee. Thus, these expenses incurred by the assessee for a commercial expediency and were wholly and exclusively for the purpose of its business. In essence, the authorities below were not justified in disallowing the cultivation expenses of Rs.90.64 lakhs claimed by the assessee. It is ordered accordingly.

8. The assessee's claim of cultivation expenses to the tune of Rs.90.64 lakhs has since been conceded by this Bench for the reasons recorded supra, the assessee's alternative plea that 'if the disallowance of cultivation expenses were to be sustained, proportionate higher deduction u/s 10B of the Act ought to have to be allowed' became redundant and, thus, it has not been addressed to.

9. In the result , the assessee's appeal is partly allowed.