IN THE INCOME TAX APPELLATE TRIBUNAL
"B" BENCH : BANGALORE

BEFORE SHRI N.V. VASUDEVAN, JUDICIAL MEMBER AND
SHRI JASON P. BOAZ , ACCOUNTANT MEMBER

ITA No.571/Bang/2014
Assessment year : 2008-09

Bosch Limited, Hosur Road, Audogodi, Bangalore – 560 030. **PAN: AAACM 9849P**	Vs.	The Deputy Commissioner of Income Tax, LTU, Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Shri K.P. Kumar, Advocate
Respondent by	:	Smt. Neera Malhotra, CIT(DR)

Date of hearing	:	24.09.2015
Date of Pronouncement	:	28.10.2015

O R D E R

Per N.V. Vasudevan, Judicial Member

This appeal by the assessee is against the order dated 7.3.2014 of the Commissioner of Income-tax, LTU [CIT], Bangalore passed u/s. 263 of the Income-tax Act, 1961 ["the Act"] relating to assessment year 2008-09.

2. The assessee is a company engaged in the business of manufacture of fuel injection equipments, auto electric items, portable electric power tools, etc. For the AY 2008-09, an order dated 22.11.2011 u/s. 143(3) was passed. One of the items of claim which was examined by the AO in the said order was the claim of assessee for deduction u/s. 35(2AB) of the Act of Rs.20,68,01,388. The dispute was as to whether deduction u/s. 35(2AB) has to be allowed with reference to gross expenditure or on the net expenditure i.e., gross expenditure minus receipts of the assessee from the activity of R&D. Deduction u/s. 35(2AB) of the Act was allowed by the AO only on the net amount as he noticed that in the computation of income filed by the assessee, the assessee had claimed the said deduction only on the net amount. Therefore, no separate deduction was made on this score.

3. The CIT in exercise of his powers u/s. 263 of the Act was of the view that deduction allowed by the AO u/s. 35(2AB) was erroneous and prejudicial to the interests of the Revenue. According to the CIT, the expenditure incurred on R&D was certified by the Department of Scientific & Industrial Research (DSIR), Govt. of India. He found that the assessee had two Export Oriented Units (EOU) units at Naganathapura and another one at Nashik and the profits of both these units were entitled to 100% deduction u/s. 10B of the Act as they were EOUs. According to the CIT, the assessee was in the business of manufacture of automotive parts such as fuel injection equipment, auto electric equipments that are manufactured

in all the units including the EOUs Naganathapura and Nashik. According to the CIT, benefits of R&D would accrue to all the manufacturing units of the assessee. The CIT further noticed that in the Profit & Loss account of EOUs at Naganathapura and Nashik, the expenditure on scientific research claimed and allowed as deduction u/s. 35(2AB) of the Act had not been apportioned and debited to the P&L account of the two EOUs and thereby the eligible deduction u/s. 10B of the Act was allowed in excess by the AO. The CIT apportioned the total R&D expenditure and came to the conclusion that had the R&D expenditure been apportion and debited to the P&L account of the two EOUs, then their profits would stand reduced to Rs.30,58,36,266 as against the claim u/s. 10B allowed by the AO at Rs. 49,64,24,425. The CIT was of the view that excess deduction u/s. 10B of the Act to the extent of Rs.19,05,88,159 had been allowed to the assessee [Rs.49,64,24,425 minus 30,58,36,266]. The CIT was therefore of the view that the order passed by the AO was erroneous and prejudicial to the interests of the Revenue.

4. In reply to the show cause notice u/s.263 of the Act setting out the facts as stated in para-3 above, the assessee submitted that the order passed u/s 143(3) was not erroneous and it is not prejudicial to the interest of the revenue. The Assessee pointed out that it had two EOUs one at Naganathapura and another one at Nashik. EOU at Naganathapura manufactures products such as Regulators of various types used in Alternators (MR/BR/MFR Types) which are in accordance with letter of 28th

November, 2002. EOU at Nashik manufactures products such as common rail injector parts and components thereof as per the letter of permission - reference No PER 50. (2004)/SEEPZ-SEZ/EOU/IA-II/50/04-05) dated 1st November, 2004. The Assessee further pointed out that it has an in house R&D centre recognised by department of Industrial & Scientific Research, New Delhi and as per order of approval in Form No.3CM dated 10th October, 2007. The Assessee pointed out that the objectives of the R&D were as under:

- Development of new fuel injection systems (VE EDC and CRS) to meet customer requirements with specific reference to fuel economy and environmental regulations in India and abroad for Automotive (Euro-III, BS-III) and Tractor applications (Tier-III).
- Development of electronically controlled single cylinder pumps (Euro-III).
- Development of spark plugs for the new SI engines to meet the combustion requirements of engines being development by OEMs.
- Development of high efficiency alternators to meet high current demands of modern automobiles.
- Design of lightweight, compact starter motors for automobile applications especially passenger cars and two wheelers.
- Development of start-stop systems to save fuel consumption.
- Development of body control modules and vehicular electrical architecture for indigenous passenger cars.

5. The Assessee further submitted that the products manufactured at EOUs (Naganathpura and Nashik) did not require any R&D support as the

R&D carried out is for the different products which are no way related to products manufactured at EOU. The Assessee pointed out that this fact would be is evident from the documents namely the letters of permission issued by development commissioner and Form 3CM issued by DSIR. The Assessee also drew attention of the CIT to the fact that the Assessee had entered into a technical licence agreement with Robert Bosch GmbH in respect of manufacture of common rail system and had paid lump sum royalty (i.e. technical service fee) in earlier years. Since, portion of the said technical service fee paid is attributable to EOU at Nashik, depreciation u/s 32 of the income-tax Act, on the said technical service fee amounting to Rs. 45,534,758 has been reckoned in the current AY 2008-09 and has been reduced from the profit. The Assessee pointed out that the EOU's at Naganathapura and Nashik manufacture products for which no R&D support was required and the fact that the Assessee had technical licence agreement and corresponding technical service fee has been apportioned to respective EOUs, itself would show that apportioning R&D expenditure to the said two EOUs was not required.

6. The ld. CIT after considering the reply of the assessee came to the conclusion that the stand taken by the assessee requires re-examination by the AO and accordingly set aside the order of AO on the deduction u/s. 35(2AB) of the Act and restored the issue for fresh consideration by the AO. Following were the relevant observations of the ld. CIT in this regard:-

> "The assessee's submission is perused and considered. On verification it is observed that the issue pertains to the allowability of the R&D expenses of the company on a whole without excluding the proportionate expenses attributable to the exempted units. The assessee's submission that the exempted units are not undertaking R&D support based on the approvals granted as early as 2002 and 2004 needs verification as to whether the same position exits for the said financial year which may be duly enquired by the Assessing Officer by writing to the concerned authorities. Hence the issue is remitted back to the file of the Assessing Officer to conduct suitable enquiries in this regard and decide the issue as per provisions of the Act after providing an opportunity of hearing to the assessee."

7. Aggrieved by the order of CIT, the assessee has preferred the present appeal before the Tribunal.

8. We have heard the submissions of the ld. counsel for the assessee, who reiterated the factual aspects highlighted before the CIT. Our attention was drawn to the approval dated 28.11.2002 granted by the office of the Development Commissioner, Cochin, Special Economic Zone for permission to set up 100% export oriented scheme for manufacture and export of 'Regulators of various types used in Alternators'. This was the approval for the assessee's 100% EOU plant at Naganathapura. He highlighted the fact that the expenditure incurred on R&D which was claimed as a deduction u/s. 35(2AB) of the Act was carried out in the inhouse R&D centre of the assessee which was recognized by the DSIR, New Delhi, by order dated 10.10.2007. He brought to our noticed that the aforesaid approval was in respect of development of new fuel injection

systems, electronically controlled single cylinder pumps, etc. including development of high efficiency alternators to meet high current demands of modern automobiles. He pointed out that 100% EOU at Naganathapura was only for manufacture of products such as 'Regulators of various types used in Alternators' and not manufacture of alternators. The R&D carried out by the assessee the expenditure in relation to which was claimed as deduction u/s. 35(2AB) of the Act was in connection with the development of high efficiency alternators of various types used in alternators and it had nothing to do with regulators used in alternators. He submitted that this fine distinction which was pointed out to the CIT has not been appreciated by him. According to the ld. counsel for the assessee, the CIT has proceeded on the basis that 100% EOU at Naganathapura was in the manufacture of alternators and the R&D unit expenditure incurred by the assessee which was claimed as deduction u/s. 35(2AB) also related to alternators and came to a wrong conclusion that the R&D in question would also benefit the Naganathapura unit.

9. As far as 100% EOU at Nashik is concerned, he pointed out that the approval for setting up of this unit was granted by the Govt. of India, Office of Development Commissioner, SEEPZ, SEZ dated 1.11.2004 and the said approval is for manufacture of Common Rail Injector parts and components thereof.

10. He submitted that the R&D activity carried out by the assessee for which deduction u/s. 35(2AB) was claimed had nothing to do with Common Rail Injector parts and components. He further drew our attention to the report in Form 56G of the Nashik unit as well as Naganathapura unit in which the auditors had certified the nature of activity in the Naganathapura unit as manufacture of 'Regulators of various types used in Alternators' and the activity in the Nashik unit as 'manufacture of CRI parts and components'.

11. The ld. counsel for the assessee submitted that in the light of the aforesaid explanation given by the assessee in reply to show cause notice u/s 263 of the Act, the CIT has not given a finding that the details given by the assessee are incorrect. The CIT has also not come to the conclusion in the impugned order that the claim made by the assessee is erroneous. It was submitted by him that jurisdiction u/s. 263 of the Act can be exercised by the CIT only on satisfaction of two conditions viz., the order sought to be revised should be erroneous and secondly, it should be prejudicial to the interests of the revenue. According to him, the CIT has not come to the conclusion that the order of AO is erroneous and therefore jurisdiction u/s. 263 of the Act ought not to have been exercised by the CIT.

12. Our attention was drawn to the decision of the Hon'ble Punjab & Haryana High Court in the case of *CIT v. Kanda Rice Mills, 178 ITR 446 (P&H)*. The Hon'ble High Court in the aforesaid case while examining the

correctness of an order passed u/s. 263 of the Act, held that the Commissioner cannot set aside the assessment order with a direction to make fresh assessment, without giving his opinion on the contentions put forth by the assessee in reply to the show cause notice u/s. 263 of the Act. The Hon'ble High Court further held that CIT by merely observing that certain points deserved consideration, cannot exercise powers u/s. 263 of the Act.

13. Our attention was also drawn to the decision of the Hon'ble High Court of Karnataka in the case of *CIT v. D.G. Gopala Gowda, 354 ITR 501 (Karn)*, wherein it was observed that the order passed u/s. 263 should indicate the error committed by the assessing authority and consequently prejudice caused to the revenue. It was further held that after finding that the order is erroneous and prejudicial to the interests of revenue, the revisional authority cannot simply remand the issue to the AO for fresh consideration, but should set out the facts which show the erroneous nature of the order and consequential prejudice caused to the revenue which confer jurisdiction on the revisional authority.

14. The ld. DR, on the other hand, pointed out that the AO while completing the assessment did not consider this aspect at all and this was the reason for prompting an action u/s. 263 of the Act. It was further submitted that failure to make an enquiry by the AO renders the order erroneous and prejudicial to the interests of the revenue. It was further

submitted that since the facts were required to be examined in detail, the CIT had remanded the issue to the AO for fresh consideration. The ld. DR referred to the following decisions laying down the proposition when detailed examination is required, the CIT has the power to remand the issue to the AO for fresh consideration:-

CIT v. Shri Bhagwan Das, 272 ITR 367 (All)
Bank of India v. CIT, 152 TTJ 546 (Chennai)

15. We have considered the rival submissions. From the factual details pointed out by the ld. counsel for the assessee which was also pointed out in the reply to show cause notice u/s. 263 of the Act before the CIT(A), it is clear that the R&D activity which was carried out by the assessee in Bangalore had nothing to do with the activities carried on by the assessee at 100% EOUs at Naganathapura and Nashik. Naganathapura unit of the assessee was manufacturing Regulators of various types used in Alternators and the Nashik unit was manufacturing Common Rail Injector parts and components. From the perusal of the activities carried out at Bangalore by the assessee, the expenditure in respect of which deduction was claimed u/s. 35(2AB) of the Act, it is clear that none of the activities so carried out related to the activities carried on by the assessee at Naganathapura and Nashik units. In such circumstances, the question of apportionment of R&D expenditure under the two units for which deduction u/s. 10B was claimed and allowed does not arise for consideration at all.

As rightly contended by the ld. counsel for the assessee, one of the items of R&D carried out by the assessee is development of high efficiency alternators. Naganathapura unit was not manufacturing alternators, but was only manufacturing regulators used in the alternators. R&D activity for manufacture of alternators cannot be equated with regulators used in alternators. It appears to us that this fine distinction had not been appreciated by the CIT, though pointed out by the assessee in reply to show cause notice u/s. 263 of the Act.

16. As rightly contended by the ld. counsel for the assessee, when the above facts were brought to the notice of the CIT(Appeals) in reply to the show cause notice u/s. 263, it was incumbent on the part of CIT before remanding the issue to the AO for fresh consideration, to come to the conclusion that the assessee's reply was not acceptable. Without giving such a finding, it was not open to the CIT to set aside the order of AO.

17. The decision rendered by the Hon'ble Punjab & Haryana High Court in the case of *Kanda Rice Mills (supra)* clearly support the arguments put forth by the ld. counsel for the assessee before us. As laid down by the Hon'ble High Court of Karnataka in the case of *D.G. Gopala Gowda (supra)*, it was incumbent on the part of CIT exercising power u/s. 263 of the Act to bring out the erroneous nature of the order of AO in light of the reply given by the assessee in the impugned order. In CIT Vs. Gabriel India Ltd. 203 ITR 108 (Bom) it was held that from a reading of sub-section (1)

of Section 263 of the Act, it is clear that the power of suo motu revision can be exercised by the Commissioner only if, on examination of the records of any proceedings under this Act, he considers that any order passed therein by the Income-tax Officer is "erroneous in so far as it is prejudicial to the interests of the Revenue". It is not an arbitrary or unchartered power. It can be exercised only on fulfilment of the requirements laid down in sub-section (1). The consideration of the Commissioner as to whether an order is erroneous in so far as it is prejudicial to the interests of the Revenue, must be based on materials on the record of the proceedings called for by him. If there are no materials on record on the basis of which it can be said that the Commissioner acting in a reasonable manner could have come to such a conclusion, the very initiation of proceedings by him will be illegal and without jurisdiction. The Commissioner cannot initiate proceedings with a view to starting fishing and roving enquiries in matters or orders which are already concluded. Such action will be against the well-accepted policy of law that there must be a point of finality in all legal proceedings, that stale issues should not be reactivated beyond a particular stage and that lapse of time must induce repose in and set at rest judicial and quasi-judicial controversies as it must in other spheres of human activity.

18. The learned DR's reliance on the decision of the Hon'ble Allahabad High Court and that of the ITAT Chennai in *CIT v. Shri Bhagwan Das, 272 ITR 367 (All)* and *Bank of India v. CIT, 152 TTJ 546 (Chennai)*, in our view,

will not help the case of the Revenue. Failure to make enquires which the AO ought to have made in the given facts and circumstances of a case might render the order of the AO erroneous. In the present case however the Assessee has demonstrated that the enquiries contemplated by the CIT in the show cause notice u/s.263 of the Act, were not required at all and this fact is also accepted by the CIT in the impugned order. He has only remanded the issue to AO for verification of an insignificant issue whether of approval of the Naganathapura unit and the Nashik unit continues even during the previous year and has been demonstrated by the Assessee before CIT with sufficient documentary evidence. In such circumstances, there was no necessity to have remanded the issue to AO for fresh consideration.

19. It is further seen that the CIT in the impugned order has accepted that if R&D activity and the activity carried on at the 100% EOUs were different, then there was no need to apportion the R&D expenses of the two EOUs. His apprehension is only that the approvals for 100% EOUs were granted as early as 2002 and 2004 and as to whether those units were carrying on the same activity required to be examined. In this regard, as rightly pointed out by the ld .counsel for the assessee, certificate of the Chartered Accountant given in Form 56G for both these units clearly mention the nature of activities of those two units for the previous year relevant to AY 2008-09 are the same activity for which the approvals were granted to these 100% EOUs. It has thus been clearly demonstrated by

the assessee before the CIT(A) that the expenditure on R&D had no connection whatsoever with the 100% EOUs at Naganathapura and Nashik. In the given circumstances of the case, we are of the view that there was no necessity for the CIT to have set aside the order of AO for suitable enquiries and deciding the issue afresh.

20. We therefore hold that the order of the Assessing Officer u/s. 143(3) on the issue of deduction u/s. 35(2AB) of the Act insofar it relates to those expenses being not related to Naganathapura and Nashik units is neither erroneous nor prejudicial to the interests of the Revenue. We therefore quash the impugned order u/s. 263 of the Act and allow the appeal of the assessee.

21. In the result, the appeal by the assessee is allowed.

Pronounced in the open court on this 28th day of October, 2015.

Sd/-	Sd/-
(JASON P. BOAZ) Accountant Member	(N.V. VASUDEVAN) Judicial Member

Bangalore,
Dated, the 28th October, 2015.

/D S/

Copy to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.
6. Guard file

By order

Assistant Registrar
ITAT, Bangalore.