IN THE INCOME TAX APPELLATE TRIBUNAL
*KOLKATA BENCH "**B**" KOLKATA*

Before **Shri Mahavir Singh, Judicial Member** and
Shri Waseem Ahmed, Accountant Member

ITA No.1194/Kol/2010
Assessment Year :2004-05

International Seaports (Haldia) Pvt. Ltd. C/o. Shri Somnath Ghosh, Advocate, Seventh Brothers Lodge, P.O. Buroshibtala, P.S. Chinsurah, Dist. Hooghly, Pin 712 105 [**PAN No.AAAACI 9468 D**]	**V/s.**	Income Tax Officer, Ward-12(3), Aaykar Bhavan, P-7, Chowringhee Square, Kolkata-700 069
अपीलार्थी /Appellant	..	प्रत्यर्थी/Respondent

अपीलार्थी की ओर से/By Appellant	Shri Somnath Ghosh, Advocate
प्रत्यर्थी की ओर से/By Respondent	Shri Debasish Banerjee, JCIT-SR-DR
सुनवाई की तारीख/Date of Hearing	10-12-2015
घोषणा की तारीख/Date of Pronouncement	20-01-2016

आदेश /O R D E R

PER Waseem Ahmed, Accountant Member:-

This appeal by the assessee is arising out of order of Commissioner of Income Tax (Appeals)-XXXV, Kolkata in appeal No.34/CIT(A)-XXXVI/Kol/Ward-12(3)/06-07 dated 19.03.2010. Assessment was framed by ITO Ward-12(3), Kolkata u/s 143(3) of the Income Tax Act, 1961 (hereinafter referred to as 'the Act') vide his order dated 29.12.2006 for assessment year 2004-05 and the assessee raised the following grounds:-

"1. FOR THAT the Ld. Commissioner of Income Tax (Appeals) XXXVI, Kolkata acted unlawfully and with material irregularity in upholding the additions in the sums of Rs.3,00,18,070/- made on account of the alleged income from cargo handling charges, Rs.16,84,582/- made on account of the alleged income from berth hire charges and Rs.2,22,23,527/- made on account of the allege discrepancy in TDS certificates in the assessment order passed u/s. 143(3) of the Income Tax Act, 1961 by the Ld. Income Tax Office, Ward 12(3), Kolkata in gross violation of the provisions of s. 142(3) of the Income Tax Act, 1961 and the purported actions in respect of those issues are altogether illegal, invalid and untenable in law.

2. FOR THAT the Ld. Commissioner of Income Tax (Appeals) XXXVI, Kolkata misread the facts and circumstances of the instant case in upholding the purported action of the Ld. Income Tax Officer, Ward 12(3), Kolkata of construing the receipts from trial run in the sum of Rs.3,17,02,632/- as income of the appellant and the alleged findings in this regard without considering the issues in a proper perspective are altogether arbitrary, unwarranted and perverse.

3. FOR THAT the Ld. Commissioner of Income Tax (Appeals) XXXVI, Kolkata in upholding the impugned finding of the Ld. Income Tax Officer, Ward 12(3), Kolkata of interpreting the receipts from trial runs to the tune of Rs.3,17,02,632/- as revenue in nature relying on the ratio laid down in the case of TUTIKORIN ALKALI CHEMICALS & FERTILIZERS LTD. –VS CIT [1997] 227 ITR 172 (S.C) is not in consonance with law as well as on facts as the issues are thoroughly distinguishable and the impugned finding on that behalf is wholly capricious, flawed, erroneous and perverse.

4. FOR THAT the Ld. Commissioner of Income Tax (Appeals) XXXVI, Kolkata was wrong on the facts and in law in upholding the purported action of the Ld. Income Tax Officer, Ward 12(3), Kolkata of incorporating the work-in-progress of Rs.2,22,23,527/- as income earned in the assessment year under dispute without arriving at any adverse inference on the method of accounting followed by the appellant and his alleged action on that behalf is altogether unlawful, illegal, unjust, biased and capricious.

5. FOR THAT the Ld. Commissioner of Income Tax (Appeals) XXXVI, Kolkata gravely erred in upholding the impugned finding of the d. Income Tax Officer, Ward 12(3), Kolkata of construing the income disclosed in the assessment year 2005-2006 as income in the concerned assessment year without judiciously considering the reconciliation submitted in this regard by the appellant and the

purported action on that count is thoroughly unjust, improper and unsustainable in law."

2. The first issue raised by the assessee in this appeal is that the ld. CIT(A) erred in treating the receipt of ₹3,17,02,632/- from trial run of berth hire charges as business income.

3. The facts of the case are that the assessee is a Private Ltd. Company which is engaged in the business of port development and inter alia has income from the activity of cargo handling and berth hire charge. The assessee was awarded a contract to build a berth no. 4A at Haldia Dock Complex. As per the contract the assessee was to conduct the trial run of the port before the start of commercial operation. The assessee began the trial run on the date 7-12-2003 and ended on dated 13-01-2004. The actual commercial operation started immediately after the successful completion of trial run on dated 15.01.2004. During the trial run, assessee has earned income for cargo handling charges of Rs.3,00,18,070/- and Rs.16,84,562/- for berth hire charges (total Rs. 3,17,02,632.00). The assessee has not offered the income for tax, earned during the trial run but adjusted to the pre-operative expenses.

4. However the AO observed that the trial run begins only after the completion of the project. Hence the income earned during the trial cannot be reduced from the preoperative expenses. Accordingly, the AO sought clarification from the assessee on adjusting the trial run income against the preoperative expenses and raised question that why trial run income should not be treated as business income.

5. The assessee submitted that prior to the start of commercial operation, only few vessels were handled to have the trial run of the system and treated as 'preoperative handling' of the plant. Therefore the income generated during trail run has been treated as 'preoperative income'. As a result of this the pre-

operative expenses has come down by the said amount and the balance has been capitalized after apportioning to the assets.

6. However, the AO disregarded the claim of the assessee and disallowed the same relying on the judgment of Hon'ble Apex Court in the case of *Tutikorin Alkali Chemicals & Fertilizers Ltd. v. CIT* 227 ITR 172 (SC), it clearly held by **Lordship** that *"Interest earned on short-term investment of funds borrowed for setting up of factory during construction of factory before commencement of business has to be assessed as income from other sources and it cannot be held to be non-taxable or ground that it would go to reduce interest on borrowed amount which would be capitalized."*. Hence the pre-operative i.e. trial run income for Rs. 3,17,02,632.00 was added to the total income of the assessee.

7. Aggrieved, assessee preferred appeal before Ld.CIT(A) who upheld the action of AO by observing as under:-

> *"I have carefully considered the above. The appellant carried out cargo handling (of Steel Authority of India) during the period 7.12.2003 to 13.01.2004. Though it was called trial run, it had received consideration for the services rendered. The customer, SAIL also treated the same as cargo handling services and made payments accordingly. Further, TDS was also deducted, by the SAIL, from this payment. Since it was a commercial activity resulting in earning of income, I am of the view it cannot be termed as pre-operative income. I am therefore of the view that the AO has righty treated it as taxable income. Accordingly the ground No.2 is* ***dismissed****."*

Being aggrieved by this order of Ld. CIT(A) assessee preferred second appeal before us.

Shri Samnath Ghosh, Ld. Authorized Representative appearing on behalf of assessee and Shri Debasish Banerjee, Ld. Departmental Representative appearing on behalf of Revenue.

8. We have heard rival contentions of both the parties and perused the materials available on record. The ld. AR submitted the paper book which is running from pages 1 to 113 and highlighted that to make the berth ready for commercial operations the assessee was to undertake the responsibility of completing the work in accordance to the agreement of building the berth 4A. As per the agreement trial run was the pre-condition before the start of the commercial operation. The assessee treated the trial run of vessels as '*preoperative handling*' of the plant and income generated from such preoperative handling has been treated as '*preoperative income*'. In the books of account of the assessee for the previous year relevant to the assessment year under dispute, such preoperative income has been set off against the preoperative expenses of Rs.3,17,02,632/-, which consisted of berth hire charges in the sum of Rs.16,84,562/- and Rs.3,00,18,070/- being cargo handling charges and the balance amount was capitalized to be apportioned to fixed asset. The specious finding of the AO that loading and unloading of cargo during the period from 07.12.2003 to 13.01.2004 on trial basis was commercial activity of the assessee and the receipts earned there from was assessed as income from business which is totally untenable and inconsistent with the facts of the case since it was done at the behest of the Holdia Dock Complex authorities in order to establish the stability of the berth. It is an admitted fact that even during a period of test runs and experimentation, a plant may be engaged in actual production, but until the test runs are completed and the plant is properly adjusted on the basis thereof, it cannot be said to be ready for "*commercial production*". The expression "*Commercial Production*" refers to production in commercially feasible quantities and in a commercially practicable manner. Further, it is a correct and accepted procedure to capitalize all expenses incurred during construction period and in connection with the process of start-up and commissioning of the plant. In fact, such expenses would be incurred in order to bring the plant up to the stage at which it can commence commercial production. Thus, it is correct to capitalize the expenditure incurred on start-up and commissioning of the plant.

The expenditure so incurred, therefore, should be capitalized in the same way as other indirect construction expenditure. In the present context, therefore the expenditure incurred during trial run contributes to construction of the facilities at Berth No. 4A of Haldia Dock Complex as trial run activity is regarded as an activity which is necessary to prepare the asset for its intended use. This is because flaws in the facilities at Berth noticed during trial run operation are rectified to bring the Berth to its intended use. Therefore, the expenditure incurred during trial run towards building / constructing the Berth should also be capitalized as per the requirements of Accounting Standard 166. It is also an undisputed fact that operation of cargo / vessel during trial run was directly linked with the building up of facilities in the Berth No. 4A of Haldia Dock Complex. Hence, any income earned on such operation during trial run was incidental to the building of assets for setting up the Berth. Therefore, income earned during preoperative stage was a capital receipt, which would go to reduce the cost of asset and it is settled that the deposit of money was directly linked with the purchase of plant and machinery. Hence, any income earned on such deposits was incidental to the acquisition of assessee for setting up the plant and machinery. Thus, the interest was a capital receipt which would go to reduce the cost of the asset and Ld AR relied on the decision of Hon'ble Supreme Court in the case of *CIT v. Karnal Co-operative Sugar Mills Ltd.* (2000) 243 ITR 2 (SC) and *C.I.T. Vs. Bokaro Steel Limited.* (1999) 236 ITR 315 (SC)

9. From the aforesaid discussion, we find that the assessee has made some income during the period of trial run and the same was adjusted against the pre-operative expenses. The AO rejected the working of assessee and held that the income generated during the trial run income period cannot be adjusted against the preoperative expenses and the same was confirmed by the Ld. CIT(A). However, we observe that it was the condition in the agreement that the trial run has to be carried out before the beginning of commercial operation. The ld. AR drew our attention on pages 17,18,19,20,21

of the Paper Book where the requirement for the trial run was requested before the beginning of actual operation. The purpose of the trial run was to check whether there is any flaw in the system or not so that remedial action can be taken well in time in the event of any flaw in the system. So it is clear that the purpose of the trial run was to check the flaw in the system and not to begin the commercial operations. In the instant case the trial run was successfully completed on dated 13/1/2004 without any flaw in the system. Therefore the commercial operation began immediately thereafter on dated 15/1/2004. Now the question here arises that in case of any flaw caught during the trial run then in that event certainly the commercial operation shall only begin after the removal of the flaw. In view of thi,s the income generated during trial run shall certainly be adjusted against the pre-operative expenses. Having said this we are inclined to reverse the order of the ld. CIT(A) and direct the lower authorities to adjust the trial run income from preoperative expenses of the assessee. We are relying on the judgment of the Delhi High Court in the case of Commissioner of Income Tax Vs. Nestor Pharmaceuticals Limited 322 ITR 631 where it was held that :

> *"The assessee was in the business of manufacture of pharmaceutical formulation in bulk drugs and supplying drugs to the Government hospitals, institutions besides selling the product in domestic and foreign markets. It claimed the benefit under section 80-IA/80-IB of the Income-tax Act, 1961. It carried out trial production from March 20, 1998. On that basis the Assessing Officer treated the assessment year 1998-99 as the initial year for the benefit claimed and since this benefit was allowable for five years, according to the Assessing Officer, this benefit was admissible from the assessment year 1998-99 to the assessment year 2002-03. The assessee on the other hand claimed the benefit from the assessment years 1999-2000 to 2003-04. The plea of the assessee was that trial production did not amount to manufacture of its products. It was only when commercial production commenced, which, according to the assessee, commenced only in the assessment year 1999-2000 that production commenced. The Commissioner (Appeals) confirmed the order of the Assessing Officer but the Tribunal reversed that order holding that section 80-IA/80-IB of the Act being beneficial legislation, the benefit should be extended to the assessee. It further held that as on March 20,1998, only trial production started which was different from commercial production and the benefit of that section should be allowed in the year in which commercial production*

started, i.e. in the assessment year 1999-2000 and, therefore, would be extendable up to the assessment year 2003-04. On appeal :

Held, that the initial assessment year, for the purpose of section 80-IA, was the assessment year relevant to the previous year in which the "industrial undertaking begins to manufacture or produce articles or things". The trial production began on March 20, 1998, as per the details given in the audit report furnished by the assessee along with its returns of income for the assessment years 2003-04 and 2004-05. There was no dispute that the first sale was made on April 23,1998, which would be the period relevant to the assessment year 1999-2000. Merely because some closing stock was shown as on March 31, 1998, that would not lead to the conclusion that there was commercial production as well. Even for the purpose of trial production material would be needed and there would be production which would result in stock of finished goods. The evidence produced by the assessee was accepted by the tribunal as well, from which it was clear that there was only a trial production in the assessment year 1998-99 and commercial and full-fledged production commenced only in the year 1999-2000. The order of the Tribunal allowing the benefit of deduction under section 80-IA/80IB of the Act from the assessment year 1999-2000 treating it as the initial year of production to the assessment year 2003-04 was correct in law.

The Tribunal held that the assessee had not only produced the goods for trial purposes but there was, in fact, sale of one water cooler and air-conditioner in the assessment year 1998-99 relevant to the previous year/financial year 1997-98. The explanation of the assessee was that this was done to file the registration under the Excise Act as well as the Sales tax Act. The Tribunal held that the sale of one water cooler and one air-conditioner as on March 31, 1998, for the purpose of obtaining registration of excise and sales tax was manufacture within the meaning of section 80-IA. On appeal :

Held, that the assessee had sold one water cooler and one air-conditioner before April, 1998. Thus, the stage of trial production had been crossed and the assessee had come out with the final saleable product which was in fact sold as well. The quantum of commercial sale would be immaterial. With sale of those articles marketable quality was established, more particularly when the assessee failed to show that the dealer returned those goods on the ground that there was any defect in the water cooler or air-conditioner produced and sold by the assessee to the dealer. The Tribunal, in the circumstances, was right that the two types of conditions stipulated in section 80-IA were fulfilled with the commercial sale of the two items in that assessment year. Whether the

purpose of that sale was to obtain registration of excise or sales tax would be immaterial."

The Bombay High Court has also decided the similar issue in favour of assessee in the case of CIT Vs. Hindustan Antibiotics Ltd.(1974) 93 ITR 548 (Bom) and relevant extract of the order is reproduced below :

"The word "articles" used in the expression "has begun or begins to manufacture or produce articles "in section 15C(2)(ii) must be interpreted regard being had to the object for which the section was enacted. The provision was enacted with a view to encouraging the establishment of new industrial undertakings and the object was sought to be achieved by granting exemption from tax on profits derived from such undertakings during the first five years. The object of the section presupposes that profits are capable of being earned. Hence, until an assessee reaches a stage where it is in a position to decide that a final product which can be ultimately sold in the market can be manufactured it cannot be said to have started manufacture of the articles. If it becomes necessary for an assessee to produce a trial product at an earlier stage to verify whether it can be used ultimately in the manufacture of the final article, the commencement of operation for the manufacture of the trial product would not constitute commencement of manufacture of articles for the purposes of section 15C.

The assessee-company undertook a project for the manufacture of penicillin. It started actual operations for the manufacture of crude penicillin in December 1954. The first samples of crude penicillin were required to be sent to U.S.A. and U.K. for obtaining certificates as to their qualities. The certificates were obtained in June, 1955, and the assessee started regular production of sterile penicillin, the only product that could be sold in the market, in August, 1955. On the question when the manufacture of sterile penicillin had started and whether the assessee was entitled to the exemption under section 15C for the assessment year 1960-61 :

Held, on the facts, that production of articles by the assessee had begun only in August, 1955. The benefit of the exemption under section 15C arose to the assessee for the first time in the assessment year 1956-57 and, therefore, it was entitled to the exemption under section 15C for the assessment year 1960-61 also."

10. We also further observe that the facts of the case law cited by the AO i.e. *Tutikorin Alkali Chemicals & Fertilizers Ltd.* (supra) for treating the receipts

of trial run as business receipt are different from the facts of the instant case. The Apex Court in the said case has treated the interest income on the surplus fund as income from other sources because there was no nexus between the activity of the assessee and interest income. The assessee has invested idle fund for short period of time before the commencement of the business. There was no connection between interest income and the business of the assessee. The interest income was independent and separate from the business of the assessee. However in the instant case the income generated during trial run is very much connected with the business of the assessee hence the question of recognizing the income does not arise as the commercial operation has not began. In view of above we reverse the order of the ld. CIT(A) and allow the appeal of the assessee.

11. The second issue raised by the assessee is as regards that ld. CIT(A) erred in confirming the order of the AO by treating the work in progress of Rs. 2,22,23,527/- on account of TDS certificate.

12. During the year the assessee has disclosed income from operations and work-in-progress for an amount of Rs.7,34,25,493/-. However, as per the TDS certificate the assessee's earned income Rs.12,13,61,939/- as detailed under:

Sl No.	Name of			
1	Interest other that interest on	72,685	14,901	Union Bank of India
2	-do-	58,536	12,000	-do-
3	Port payment	4,98,489	10,218	Intro shipping
4	Payment to Contractor	11,99,98,606	24,59,977	SAIL
5	-do-	2,46,500	5,160	Chowringhee
6	-do-	2,01,322	4,214	
7	-do-	1,46,750	3,071	-do-
8	-do-	1,39,050	2,910	-do-
	¤ Total	12,13,61,939	25,12,451	25,12,451

The AO sought the clarification for the difference arising between the income declared and the income from the TDS certificate. The assessee submitted as under:-

1)	Income from operations as per P & L A/c	Rs.	6,73,04,559.00
2)	Add : Income during trial run	Rs.	3,17,02,632.00
3)	Add : Bank interest (pre-operative income)	Rs.	1,31,221.00
	Total	Rs.	9,91,38,412.00
4)	Income as per TDS certificate	Rs.	12,13,61,939.00
	Difference (short income)	Rs.	2,22,23,527.00

The reason for the difference was explained that the M/s SAIL has deducted TDS on the work in progress account also and the assessee has not shown such work-in-progress as Revenue account during the year. The assessee has booked such income in the subsequent year i.e. 2004-05 the financial year. However the assessee disregarded the claim of the assessee on the ground that the assessee was in receipt of such income which should have been disclosed in the return of income. Therefore the discrepancy arising from the TDS certificate for an amount of Rs.2,22,23,527/- was added to the total income of the assessee.

13. Aggrieved, assessee preferred appeal before Ld. CIT(A) who confirmed the action of AO by observing as under:-

> *"I have carefully considered the above. Apparently, the entire amount of Rs.12,13,61,939/- were received by the appellant towards cargo handling operations and other receipts. Further, M/s Steel Authority of India Ltd. has treated the above payment to the appellant towards charges for operations. Further, no evidence was filed before me to indicate that the above sum of Rs.22,22,23,527/- represents work-in-progress but not receipts towards operations. Considering the above, I do not find any reasons to interfere with the assessment order. Accordingly, this ground No.3 is **dismissed**."*

Being aggrieved by this order of Ld. CIT(A) assessee preferred second appeal before us.

14. We have heard rival contentions and perused the materials available on record. Ld. AR submitted that it is also not in dispute that the alleged finding of the Ld. Assessing officer on the issue of discrepancy of Rs.2,22,23,527/- is simply an issue which arose from a future imagination. It was apprised that Steel Authority of India, the contractor had deducted tax on the total payment made to the appellant which was shown by the appellant as Work-in-progress. It was also apprised to the Ld. Assessing Officer that the same was duly disclosed in the subsequent assessment year 2005-2006. However, the Ld. Assessing officer did not enquire about the veracity of the explanation furnished by the appellant. It was his view that, such sum was not offered as income by the appellant in its Profit & Loss Account and accordingly the impugned amount is liable to be considered as income for the assessment year under dispute. The approach of the Ld. Assessing Officer in this respect is one sided. It is axiomatic that when there was difference with the figures of a party with that of the assessee, it was the duty of the Ld. Assessing officer to provide opportunity to the appellant to resolve any alleged discrepancy. As a result, the approach of the Ld. Assessing officer was contrary to law and as such, the addition made on the specious premise of “discrepancy of TDS” in the sum of Rs.2,22,23,527/- on a tenuous justification solely depending on extraneous facts not germane to the issue is thoroughly untenable and the Ld. Commissioner (Appeals) in upholding such impugned specious addition has wrongly construed the facts of the case which is therefore unsustainable being diametrically opposed to law. On the other hand the ld. DR relied on the orders of authorities below.

15. From the aforesaid discussions we find that the AO has found out that the assessee has understated his income on basis of the discrepancy noticed in the TDS certificate. On the other hand the ld. AR submitted that the assessee has taken advance from the party during the year against which the amount of work in progress was shown in the balance sheet of the assessee. The ld. AR further submitted that such work in progress has been offered to

tax in the subsequent year. The ld. AR has submitted the financial statement of the subsequent year of the assessee in support of his claim. Now the question before us is to check whether the income of the assessee has been offered to tax or not. So for this purpose we are restoring the file to the AO with the direction to check whether the income of the assessee has been disclosed in the subsequent year or not. If yes then delete the addition made by the assessee. In view of the above, this ground of the assessee is allowed for statistical purposes.

16. **In the result, assessee appeal is partly allowed for statistical purposes.**

Order pronounced in the open court 20/01/2016

Sd/-	Sd/-
(Mahavir Singh)	(Waseem Ahmed)
(Judicial Member)	(Accountant Member)

Kolkata,

*Dkp
दिनांकः- 20/01/2016 **कोलकाता ।**

आदेश की प्रतिलिपि अग्रेषित / Copy of Order Forwarded to:-

1. अपीलार्थी/Appellant-International Seaports(Haldia) Pvt. Ltd., C/o Shri Somnath Ghosh, Advocate, Seven Brothers Lodge, P.O.Buroshibtala, P.S. Chinsura Dist. Hooghly, pin 712 105
2. प्रत्यर्थी/Respondent-ITO, Ward-12(3), Aaykar Bhavan, P7, Chowringhee Sq., Kol-69
3. संबंधित आयकर आयुक्त / Concerned CIT Kolkata
4. आयकर आयुक्त- अपील / CIT (A) Kolkata
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, **कोलकाता** / DR, ITAT, Kolkata
6. गार्ड फाइल / Guard file.

By order/आदेश से,

/True Copy/

उप/सहायक पंजीकार
आयकर अपीलीय अधिकरण,
कोलकाता ।