IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "G" NEW DELHI

BEFORE SHRI AMIT SHUKLA, JUDICIAL MEMBER
&
SHRI PRASHANT MAHARISHI, ACCOUNTANT MEMBER

I.T.A. No.2285/DEL/2014
Assessment Year: 2008-09

DCIT, Circle-9(1), New Delhi.	v.	M/s. Solaris Chemtech Industries Ltd., Thapar House, 124, Janpath, New Delhi.
TAN/PAN: AABCB 7121R		
(Appellant)		(Respondent)

Appellant by:	Shri Kaushlendra Tiwari, Sr.D.R.		
Respondent by:	Ms. Reena Lamba, C.A. & Shri Mohit Bansal, C.A.		
Date of hearing:	15	03	2018
Date of pronouncement:	11	06	2018

O R D E R

PER AMIT SHUKLA, J.M.:

The aforesaid appeal has been filed by the Revenue against the impugned order dated 20.01.2014, passed by ld. CIT (Appeals)-XI, New Delhi for the Assessment Year 2008-09. In the grounds of the appeal, Revenue has raised the following grounds:-

"On the facts and in the circumstances of the case, the CIT(A) has erred in disallowing depreciation on WDV of trial run expenditure which was capitalised in A.Y. 2004-05.

2. *On the facts and in the circumstances of the case, the CIT (A) has erred in disallowing depreciation of WDV of product development expenditure and technical knowhow fees capitalized*

in earlier assessment years.

3. *On the facts and in the circumstances of the case, the CIT(A) has erred in deleting the addition made by AO u/s. 14A amounting to Rs.8,53,651/.*

4. *On the facts and in the circumstances of the case, the CIT(A) has erred in deleting the addition made by the AO amounting to Rs. 1,60,07,1007- invoking section 40(a)(ia) of the Income Tax Act, 1961 on account of Royalty.*

5. *The appellant craves to amend modify, alter, add or forego any ground of appeal at any time before or during the hearing of this appeal."*

2. The brief facts qua the issue raised in grounds no.1 & 2 are that, the assessee-company was engaged in the business of manufacturing and sale of citric acid having manufacturing unit located at Baroda, Gujarat. With effect from 1st July, 2007, M/s. Solaris Chemtech Ltd. merged with assessee-company. It was also dealing in the business of manufacturing and sale of industrial chemicals. Learned Assessing Officer noted that the assessee company has claimed depreciation of Rs.20,99,84,939/- on a total cost of assets worth Rs.123,75,67,692/-. These assets also included an amount of Rs.46,98,37,969/- which was the accumulated expenses incurred during the period of trial runs and treated it as pre-operative expenditure and was capitalized in the fixed assets in the Financial Year 2002-03. The company had commenced its commercial production from 1.4.2003. The Assessing Officer further noted that in the assessment order for the Assessment Years 2003-04 to 2006-07, the AO had

not accepted the plea of the assessee and held that production till 31st March, 2003 was a commercial production and not merely a trial production. Accordingly, pre-operative expenditure amounting to Rs.46,98,37,969/- during the period of trial run and allocated to the fixed assets have been disallowed and also carried forward of capitalization with the plant and machinery has also not been allowed. The depreciation on this amount @25% were also disallowed in the assessment order for the Assessment Year 2005-06. Following the same precedent, the Assessing Officer has computed the disallowance on account of depreciation in the following manner:-

> *"3.4 Accordingly, claim of deduction @15% of Rs.22,46,41,279/- amounting to Rs.3,36,96,190/- is disallowed and added in the income of the assessee. The working of disallowance is as under:*
>
> | | | |
> |---|---|---|
> | *Expenditure* | | *Rs.46,98,37,969* |
> | *Less Depreciation claimed:* | | |
> | *2004-05 @ 25%* | *Rs.11,74,59,492* | |
> | *2005-06 @25%* | *Rs.8,80,94,619* | |
> | *2006-07 @15%* | *Rs.3,96,42,579* | |
> | *2007-08 @15%* | *Rs.3,36,96,190* | *Rs.27,28,92,880* |
> | | *WDV as on 31.03.2008:* | *Rs.19,69,45,089* |
> | *Depreciation @15% of* | *Rs19,69,45,089=* | *Rs.2,95,41,763/-* |
>
> *(Addition – Rs.2,95,41,763/-)"*

3. Before the ld. CIT(A) detailed submission were made with regard to the disallowance of depreciation on trial and expenditure right from the Assessment Years 2004-05 to

2007-08 and also pointed out the mistake in the WDV taken by the Assessing Officer. Year-wise position of appellate order in the various years was given in the following manner:-

Asst. Year	*Amount capitalized*	*Depreciation*	*Remarks*
2004-05	*60,163,501*	*75,20,438*	*No disallowance in assessment u/s. 143(3). Disallowed u/s.147/143(3), Appeal pending with CIT(A) till date.*
2005-06	*133,349,754*	*4,64,98,204*	
2006-07	*42,403,965*	*4,54,74,644*	*Allowed in the assessment u/s.143(3)*
2007-08	*Nil*	*3,41,05,983*	*Disallowed in assessment u/s. 143(3). Allowed by CIT (A). Further set aside by ITAT vide its order dated. 31.05.2012 (Refer page no.19 to 21)*
2008-09	*Nil*	*255,79,487*	*Covered in this appeal*

4. Ld. CIT (A) held that since Assessing Officer had made the disallowance on the basis of earlier assessment order, therefore, the directions of the Tribunal in those years need to be followed and after incorporating the relevant observations of the Tribunal for the Assessment Year 2003-04, wherein the matter has been set aside to the file of the Assessing Officer and based on the same precedence he has given direction to the Assessing Officer to give consequential effect. The relevant observation and finding of the CIT (A) for the sake of ready reference is reproduced here in below:-

"8.2 On considering the fact, it is observed that Hon'ble ITAT vide their order ITA No. 3218/D/2010 for AY 2003-04 has set aside the order of

CIT(A) observing as under:-

"5. We have heard both the parties and gone through the facts of the case. The issues as to whether the assessee undertook trial production or commercial production and when trial production ended and commercial production started, are essentially question of facts to be decided on the basis of relevant books of accounts and production records including quality control reports etc. apart from discussion with the concerned chemists/production staff in the plant. As is apparent from the facts narrated before us, according to the assessee, trial runs for manufacturing citric acid, stated to have commenced on 7.11.2001, continued in the year under consideration even when the assessee manufactured 7626 MT of citric acid and sold the same in the domestic and international markets as also paid excise duty and sales tax as against production of 1708 MT in the preceding year. Indisputably, the assessee did not produce the relevant books of accounts and production records including quality control reports etc. either before the AO or the Ld. CIT(A) while a claim was made before the Ld. CIT(A) that entire production was sold by way of scrap. No material appears to have been placed before either the lower authorities and even before us that the goods manufactured by the assessee, were returned by any of the buyers due to quality problems or were sold as a scrap. Though at the time of hearing, the Id. AR submitted copies of correspondence relating to few complaints [pg.1 to 21], it is not known as to whether or not these complaints were placed before the lower authorities nor the Ld. CIT (A) examined these aspects. We find that he lower authorities did not make any attempt-to ascertain the international and domestic rates of citric acid vis-a-vis rates .at which the assessee sold its products in order to ascertain as to whether or not the product manufactured by the assessee was really substandard, as claimed by the assessee. The manufacture of such a product without the help quality control

experts is well nigh impossible. No such reports on quality of the product were either produced before the AO or the Ld. CIT (A) and even before us. As already stated in the year under consideration domestic sale of Rs.34,56,81,771/- and export sale of Rs.2,76,86,320/- have been made. There is no material before us in order to ascertain as to whether or not the entire production of 7626 MT was substandard so as' to necessitate trial production. Hon'ble Bombay High Court in CIT vs. Hindustan Antibiotics Ltd., 93 ITR 548, observed that until the company reaches a stage where it is in a position to decide that a final product, which could ultimately be sold in the market, could be manufactured or produced by it, it will be idle formality to say that it had started manufacture or production of articles simply because trial products are prepared with a view to verify whether they can be ultimately used in the preparation or manufacture of the final products. In the present case, however, we find that no material whatsoever has been produced by the assessee before any of the income-tax authorities and even before us to show that the production made by the assessee in the year under consideration was merely a trial production and that the goods produced were not for commercial sale even when the assessee made sales in domestic market and international market of more than Rs.37 crores. Even otherwise, the Ld. CIT(A) have not recorded her specific findings as to when the trial production ended and commercial production started nor adjudicated each of the grounds of appeal of the assessee separately and nor even recorded her findings on the disallowance of expenditure, capitalized in the preceding year. In view of the foregoing, especially when complete facts and documents have not been placed before us while the matter has not be examined by the lower authorities in its proper perspective, we consider it fair and appropriate to set aside the order of the Ld. CIT(A) and restore .the matter to the file of the AO for deciding the issues raised in the

ground nos. 1 to 6 in the appeal afresh, in accordance with law in the light of our aforesaid observations, after examining all the relevant books or accounts and records of production, including quality control reports etc and of course after allowing sufficient opportunity to the assessee. Needless to say that while re-deciding the issues, the- AO shall pass a speaking order, bringing out clearly as to when the trial production ended and commercial production started. The assessee is also directed to cooperate in the assessment and place all the relevant facts within their specific knowledge and produce all the relevant books of accounts including production records and quality control reports before the AO .With these observations, ground nos. 1 to 6 in the appeal are disposed of"

8.3. It is also observed that the appellant's case for AY 2004-05 to AY 2007-08 have also been restored back to the AO by Hon'ble ITAT vide ITA No. 5044 to 5046/Del/2010 and ITA No. 987/Del/2011 on the Trial run expenditure. In respect of Product Development & Technical Know-How, it was pleaded that since the assessment proceedings in the first year (AY 2004-05) has been reopened and the allowability of depreciation shall be dependent on WDV to be brought forward from the past years (namely from AY 2007-08), the Hon'ble ITAT vide their order ITA No. 2036/Del/2011 have restored the matter to the file of AO for AY 2007-08 on this issue.

8.4. In view of the above facts, since both the issues are dependent upon the verification to be made by the AO in AY 2003-04 and AY 2004-05 and thereafter giving consequential effect to the results in subsequent AYs, the AO is directed to give consequential effect on both the issues in the appellant's case pertaining to the year under consideration also. With these directions ground no. 1 and 2 of appeal are partly allowed."

5. After hearing both the parties, we find that the Assessing Officer has disallowed the depreciation on WDV of trial and expenditure which was capitalized in the Assessment Year 2004-05 by following the earlier assessment orders. Right from the Assessment Years 2004-05 to 2007-08 the matters have been restored back by the Tribunal on this issue to the files of the Assessing Officer and whatever would be the outcome in the set aside proceedings Assessing Officer has to give consequential effect in the impugned Assessment Year also. We do not find any infirmity in such a direction of the ld. CIT (A) which in turn is based on the direction of the Tribunal. Accordingly, grounds no.1 and 2 as raised by the Revenue are dismissed.

6. In so far as the disallowance made u/s.14A of Rs.8,53,651/-, the facts and brief are that the Assessing Officer noted that assessee has earned dividend income of Rs.36,60,482/- which was claimed as exempt, against which assessee has attributed sum of Rs.6,28,332/- towards expenses attributable for earning of such dividend income. The Assessing Officer however held that, since assessee has not calculated the disallowance in accordance with Section 14A read with Rule 8D, therefore, he proceeded to make disallowance u/r 8D and thereby made addition of Rs.14,81,983/- and after reducing the amount of Rs.6,28,332/- in the computation of income, the AO added back the balance amount of Rs.8,53,651/-.

7. Before the ld. CIT(A), it was pleaded that while making the disallowance of interest under Rule 8D(2)(ii) Assessing Officer has taken the gross figure of interest at Rs.28,73,11,787/- in place of Rs.10,76,81,540/- taken by the assessee. The difference amount of Rs.17,96,30,247/- was interest capitalized, financial charges and interest on loan. Hence, same should not be considered for making the disallowance under Rule 8D. Ld. CIT (A) agreed with the contention of the assessee and held that interest which has been capitalized and financial charges which are paid by the assessee for conducting its manufacturing business should have been reduced from the claim of interest made by the assessee in the P&L account. Further, the interest income earned from business loan should also have been reduced from the gross interest considered by the Assessing Officer. Thus, he held that computing the disallowance of interest by taking the net interest of Rs.10,76,81,540/- by the assessee is justified and the *suo motu* disallowance made by the assessee was thus upheld.

8. After hearing both the parties and on perusal of the relevant finding given in the impugned order, we find that only dispute is with regard to disallowance of interest made under Rule 8D(ii). The assessee's case has been that the interest which was capitalized, financial charges and the interest earned on loan should be excluded while computing the disallowance; and only net interest should have been

considered. The assessee had *suo motu* worked out the disallowance after considering these factors at Rs.6,28,332/-. Learned Assessing Officer has rejected the said disallowance worked out by the assessee without even examining the nature of accounts and the interest expenditure which can be said to be attributable for the purpose of working the disallowance under Rule 8D(ii). It is mandatory that Assessing Officer should record his satisfaction as to why the claim of expenditure attributed by the assessee is not correct. Once assessee has been able to demonstrate that the entire interest expenditure debited cannot be held to be attributable, then Assessing Officer has to give a specific finding as to why such a contention cannot be accepted. We agree with the reasoning given by the ld. CIT (A) that the interest which has been capitalized; and financial charges which has been paid for conducting its manufacturing business; and also the interest from the business loan should have been reduced from the gross interest considered by the Assessing Officer, because they cannot be held to be attributable for making the investments which has yield exempt income to the assessee. Accordingly, the finding and the observation of the Ld. CIT (A) is in accordance with law and facts and the same is affirmed. Thus, ground no.3 as raised by the Revenue is dismissed.

9. Lastly, with regard to the deletion of addition of Rs.1,60,07,100/- while rejecting the provision of Section 40(a)(ia) on account of Royalty payment, the Assessing Officer

has made the addition on the ground that no supporting document in relation to deduction of tax with regard to the payment of commission and discount; cess and royalty paid during the year. Accordingly, he has added the amount to the income of the assessee u/s. 40(a)(ia).

10. Before the ld. CIT (A), the assessee contended that the Assessing Officer did not provide sufficient time for filing the TDS certificate, the copies of which were not available and same could not be produced. In fact, assessee has offered to produce copy of quarterly TDS return evidencing that tax was deducted and deposited on commission and discount. During the appellate proceedings, the assessee has furnished the copies of desired TDS certificate. On perusal and verification of these TDS certificates, the ld. CIT (A) directed to delete the disallowance on account of commission and discount. So far as payment of royalty and cess are concerned, the assessee has given the following components:-

(i)	*Cess on Salt paid to Salt Department, Govt, of India As per Sale Cess Act, 1953*	*Rs. 2,16,214*
(ii)	*Royalty on Salt paid to District Industrial Centre Jamnagar, Govt of Gujrat as per notification of Govt of Gujarat.*	*Rs.4,94,204*
(iii)	*Royalty paid to Department of Science and Industrial Research (DSIR) through National Research Development Corporation (NRDC) Under Ministry of Scientific Research*	*Rs.30,26,157*
		Rs.37,26,157

11. It was submitted that, since these payments have been made to the government and government agencies, therefore, these were to be excluded from liability of deduction of tax at source u/s.196. Based on this fact, the ld. CIT (A) has held that learned Assessing Officer is not justified in disallowing these expenses.

12. In view of the aforesaid fact that, firstly, already TDS certificates for deduction and deposit of tax has been submitted on account of payment on commission and discount then there remains no basis for making any kind of disallowance u/s.40(ia). Again with regard to payment of royalty and cess, it is quite clear that these payments have been made to the government or government agencies, and therefore, there was no liability for deduction of tax at source u/s.196. Accordingly, the order of the ld. CIT (A) is confirmed and consequently ground no.4 raised by the Revenue is dismissed.

13. In the result, the appeal of the Revenue is dismissed.

Order pronounced in the open Court on 11th June, 2018.

Sd/-	Sd/-
[PRASHANT MAHARISHI]	**[AMIT SHUKLA]**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

DATED: 11th June, 2018
PKK: