

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH: 'D' NEW DELHI**

**BEFORE SHRI BHAVNESH SAINI, JUDICIAL MEMBER
AND
SHRI L.P. SAHU, ACCOUNTANT MEMBER**

**ITA No. 2185/Del/2013
Assessment Year: 2009-10**

ITO Ward 2(1) Moradabad.	vs	Jainsons International A-3&4, Pocket SEZ, Moradabad. AAFFJ8380B
APPELLANT		RESPONDENT

Revenue by	Smt. Naina Soin Kapil, Sr. DR
Assessee by	Sh. S. Krishna, Adv. Sh. V. Rajkumar, Adv.

Date of Hearing	22.11.2018
Date of Pronouncement	01.01.2019

ORDER

PER SHRI BHAVNESH SAINI, J.M.

This appeal by Revenue has been directed against the order of Ld. CIT(A)-Bareilly dated 14.01.2013 for AY 2009-10 on the following grounds:

1. *"The Ld. CIT(A) has erred in law and on facts and circumstances of the case in allowing relief on the point of extra profit worked by the AO on account of diversion of Income of Non SEZ unit into SEZ unit to avail tax benefit.*

2. *The Ld. CIT(A) has erred in not appreciating that 99% purchase of appellate firm (SEZ unit) are from its own partner (running a Non SEZ unit) having 90% share in appellate firm, and major manufacturing expenses have been claimed in Non SEZ unit; SEZ unit showing mainly packing and other miscellaneous expenses, resulting into abnormally high profit [GP (38.46%) and NP (48.32%)]. In SEZ unit, whereas the Non SEZ unit has shown GP at 18.86% and NP at 12.81%.*
3. *The Ld. CIT(A) has erred in holding that provision of section 80IA(10) were not applicable whereas the facts of the case clearly indicate that AO has rightly invoked the provision of Section 80IA(10) of the I.T. Act, 1961.*
4. *The order of the AO deserves to be sustained on the basis of facts of the case and order of the Ld. CIT(A) is erroneous and cannot be accepted.*
5. *Any other ground of appeal which may be taken up at the time of hearing of the appeal.”*

2. Briefly the facts of the case are that the assessee firm filed return of income on 30.09.2009 declaring its total income Nil after claiming deduction of Net Profit of Rs. 5.92 crores u/s 10AA of the Income Tax Act, 1961. The assessee at the assessment stage filed the written submissions along with audit report and audited Profit and Loss account and balance sheet which have been examined by the AO. The total turnover has been shown at Rs. 12.26 crores from which Net Profit have been shown at Rs. 5.92 crores. During the year under consideration, the assessee firm has made trading in manufacturing and sale of Brass items, etc. There are two partners in assessee's firm namely Sh. Ashok Jain having 90% shares and Smt. Teena Jain have 10% shares. Shri Ashok Kumar Jain partner is also engaged in the business of Manufacturing and

Export of Brass items under the name and style of his proprietary concern M/s Jainsons International Exports, Moradabad. In his proprietary concern Shri Ashok Jain has shown turnover of Rs. 10.62 crores upon which GP and NP have been shown @18.86% and 12.81% respectively. While in the assessee firm which is located in Special Economic Zone Moradabad, the gross profit and net profit on the turnover have been shown @38.46% and 48.32% respectively. The AO on perusal of the books of accounts, bills and vouchers found that assessee firm had made 99% purchases from the proprietary concern of Sh. Ashok Kumar Jain which shows both having close connection but there is an abnormal difference in the gross profit and net profit. The AO asked for the explanation of the assessee as to why the profit of the assessee firm should not be computed by applying gross profit @18.86% of the turnover as has been shown by the proprietary concern of the partner. It was also directed that the difference of estimated and shown net profit worked out should not be treated as income from undisclosed sources. The assessee submitted before AO that GP rate is good comparative to other concerns, hence, there should not be any objection. Assessee maintained proper books of accounts, which are audited and verifiable. The same accounting system has been recognized under the Income Tax Act. From the GP and NP rate chart, it is also evident that this year 10% NP rate is high on account of more exchange rate difference received, hence, after considering this factor rest differences remains negligible and hence, to be accepted.

2.1 The AO considering explanation of the assessee noted that assessee firm has shown abnormal gross profit and net profit from its business located at SEZ Moradabad only to avoid payments of tax on its net profit being exempt u/s 10AA of the Act. There is a difference in the GP rate of assessee firm and the proprietorship concern of the partner. Substantial purchases have been made by assessee firm from the proprietary concern, which is not acceptable for deduction u/s 10AA of the Act. There is a close connection between assessee firm and the proprietorship concern of the partner, therefore, section 80-IA(8) & (10) are applicable in the case of the assessee. The AO, accordingly, rejected the book results declared by assessee. The AO for the purpose of deduction claimed u/s 10AA of the Act directed to apply GP rate of 18.86% shown by the proprietorship concern of the partner and computed the profit at Rs. 2.31 crores and net profit was computed at Rs. 3.54 crores. The assessee firm has shown net profit of 5.92 crores, therefore, difference of Rs. 2,38,40,277/- was treated as income from non special economic zone business (Rs. 5.92 crores – 3.54 crores).

3. The assessee challenged the addition before Ld. CIT(A). The written submission of the assessee is reproduced in the appellate order in which the assessee briefly explained that assessee firm is 100% Export Oriented Unit (EOU), which was established afresh pursuant to coming into vogue of Special Economic Zone Act, 2005 w.e.f. 10/02/2006. It is located in SEZ and is, therefore, covered

in terms of section 10AA of the Act and, therefore, eligible for 100% exemption on profit and gains derived from exports of articles manufactured and exported. The purchase of raw material/goods i.e. import or procurement of goods from domestic tariff area etc. as and when the goods are brought into SEZ area, its bills/invoices are checked and stamped by the concerned authority at the time of entry. As and when export sales goods leave the SEZ area, the invoices are duly checked and stamped. All incoming semi goods/unfinished goods, as well as outgoing finished goods/consignments are checked and stamped by SEZ Authorities. Benefit of Section 10AA is allowed only to units located in SEZ area and solely on the export turnover. It was submitted that SEZ unit can only import its raw material or procure through its suppliers/small time manufacturers and artisans who are registered with the DGFT and further licensed by Export Promotion Council for handicrafts. This licensed local market is called domestic tariff area. Other than from the aforesaid categories, no purchases could be made by the assessee from the open market. Thus, it may be appreciated that the entire activities of unit of assessee located in SEZ are under supervision and control of the Approval Committee constituted by the Union Government to monitor such units. There is no misuse of the exemption. The assessee complied all the condition in this case. The case of the AO had been that there was a diversion of profit from non SEZ business to SEZ business in order to claim 100% deduction of profits u/s 10AA of the Act, however, the AO has

failed to appreciate the facts of the case in the proper perspective. The assessee is located in SEZ area and enjoyed multiple benefits and privileges. One of these privileges is that it is entitled to purchase items free of custom and excise duty and commercial taxes for the purpose of its manufacturing and other related activities. Such benefit can be provided only by another entity, which is registered and recognized under the relevant law. The proprietary concern of the partner is duly registered for custom and excise duty and also trade tax and, as such, an eligible vendor for the purchase of goods by the assessee. The proprietary concern was, therefore, in a position to sale material to the assessee firm free of custom duty, excise duty and trade taxes. Purchases made from such a firm entitled the assessee to the duty drawback of DEPB benefits. It is only for this reason that the purchases have been made by the assessee firm from the proprietorship concern of the partner Sh. Ashok Kumar Jain. The assessee produced complete books of accounts, bills and vouchers to show genuine purchases have been made. The AO made the addition merely on surmises and guess work without doubting the purchases. During the assessment proceedings also, it was explained to the AO that proprietorship firm of the partner has purchased the semi finished material known in technical parlance as "Kora" at 6.26 crores from the open market. These items have been sold to the assessee firm at 6.68 crores with all the attending tax benefits. All the sales are 'H' form sales which are tax free sales. On such sales, proprietorship concern has earned net profit

rate of 6.56% from the assessee. These trading results have been accepted by the AO of the proprietorship concern vide order dated 27.12.2011 u/s 143(3) of the Act. The proprietorship concern sold "Kora" (semi finished) item which it had purchased from the open market to the assessee firm and all other improvements to the "Kora" have been done by the assessee firm. The assessee firm could not have purchased these items directly from the market otherwise it would lose all the export incentive and tax concessions. The assessee has declared proper GP and NP. In the case of proprietorship concern there were sales on account of local sales, export sales upon which different GP have been declared. Section 80-IA(8) is not applicable to the facts of the case. The assessee also explained the difference in the working of the proprietorship concern and the assessee firm because proprietorship unit is doing manufacturing as well as trading activity, however, assessee's unit is only manufacturing goods. The proprietorship unit sells, its goods in India and Abroad but assessee made exports of its goods. The proprietorship unit's economy is fully governed by local conditions, whereas the unit of assessee is dependent upon local condition partially for purchase and manufacturing but its sales are exclusively in the domain of International factors and the forex variation. Transactions have been carried out between the assessee firm and proprietorship concern at arm's length price. The AO did not bring any material on record to indicate any discrepancy with regard to the market price of "Kora" sold by proprietorship concern of the partner to the

assessee. The AO in subsequent AY 2010-11 has accepted the trading results on the same facts in the order u/s 143(3) of the Act dated 27.12.2012.

4. The Ld. CIT(A) considering the explanation of assessee and material on record deleted the entire addition his findings in para 5.3 of the order are reproduced as under:

5.3 Decision and Reasons therefor:

"I have perused the assessment order as well as the submissions made. I have also considered the evidences available on record. I find that the assessee is a 100% EOU and is a unit located in the SEZ area of Moradabad and was established under the Special Economic Zone Act, 2005. The unit is in the business of exporting handicrafts and other artefacts manufactured out of various metals and other allied material.

From a reading of a Special Economic Zone Act, 2005, I find that a SEZ unit has to essentially follow the norms specified under the Act and also has to have its activities of purchase and sale regularly monitored by the concerned authorities and it is only then that it can think of claiming exemptions u/s 10AA.

Although the proprietary concern (for short the 'Non - SEZ unit') has not been described much by the AO, but I can find from his order that it can operate in the local market for purchase and sale as it may wish and this leverage distinguishes the two units not only by their location but also for the reasons for their working and business.

The SEZ unit can purchase its raw material/unfinished goods only from units licensed by the DGFT and located in the Domestic Tariff Area. Such a unit has no option but to

only export its goods. A single violation can strip it off the privileged category list.

The Non SEZ unit on the other hand can comfortably foray into the domestic market both for purchasing its raw material as well as selling its goods. I may, at its discretion, also go in for export sales and this is why the GP on export turnover and local turnover of the non SEZ unit has varied between 38.66% to 7.16% respectively.

This being the determining factor, I hold that although the two units might be in the same kind of business, but their commercial operations and activities are materially different and hence the two units are incomparable.

It is also seen that the Assessing Officer has test checked the accounts and failed to find any error/discrepancy in the trading results of the assessee, yet he has gone on to devise a new method of prescribing GP of another unit of an uncomparable case. It is another matter though that the another unit is a sister concern of the assessee, but since the AO cannot legally take the path that he did in computing the income, the entire addition is rendered bogus being based on non appreciation of proper facts and the addition being without any cogent basis. The same deserves to be deleted especially in view of the fact that the AO has failed to find any facts and figures from the books of accounts leading to the conclusion that the SEZ unit did some other business as well calling for fresh determination of its profits and restricting the exemptions u/s 10AA. Mere recording of a finding that the assessee earns income from non SEZ business in the computation part of the order without any other relevant facts, does not allow the AO, the conclusion that he mad, while making the addition.

The whole exercise of the AO is based on suspicion and the findings recorded are lame.

I also draw support from the various rulings cited by the assessee for the proposition that addition made on

suspicion cannot take the place of proof and hence the addition, as made, being bald, does not stand the test of law.

I also find that the AO has not found fault with the purchase rate of the non SEZ unit and the department has also accepted its trading results. The assessee has placed before me order u/s 143(3) of the non SEZ unit dated 16.12.2011 wherein trading results have been accepted by the JCIT Range-2, Moradabad. There is no occasion to suggest that the business arrangement done by the assessee has any sinister overtones which could lead to an inference of a colorable device to evade tax.

I also agree with the contention put forward that section 80-IA(8) and 80-IA(10) have been incorrectly invoked and could not have been imported to the facts of the current case. I find that the AO has grossly misunderstood even the intendment of section 80IA(8) failing to realize that the “eligible business” has to be that of the assessee and something needs to be transferred there from for invocation of section 80IA(8).

I also notice that in assessee’s own case for AY 2010-11, where facts were the same as in the impugned year, the AO has himself accepted the trading results returned by the assessee vide order dated 27.12.2012 u/s 143(3).

Thus in totality of the facts and findings recorded above, I find that the addition as preferred has no legs to stand on and is, therefore, deleted. Grounds no. 1 to 3 are allowed.”

5. Ld. DR relied upon order of the AO and submitted that there is a difference in GP and NP of both the concerns. Ld. CIT(A) did not examine the books of accounts. The AO has correctly rejected the books of accounts of the assessee, which were showing abnormal profit in SEZ unit. The Ld. CIT(A) has not examined the

issue in detail, therefore, same may be restored to the file of AO for fresh assessment. The written submission of the Ld. DR is also taken on record.

5.1 On the other hand, Ld. Counsel for assessee reiterated the submissions made before authorities below. He has submitted that AO should not have by passed the audited accounts of both the concerns. The assessments of proprietorship concern have been completed by AO after satisfying himself about the facts of the case. The rates at which material was supplied by the proprietorship concern to the assessee was entirely and wholly at market rates. The facts have been verified by the Ld. CIT(A). The purchases have been made from the proprietorship concern because of the concession and privileges enjoyed by the proprietorship concern by virtue of its registration with the Export Promotion Council of handicrafts and Director General of Foreign Trade. The provisions of Section 80-IA(8) are not applicable to the facts of the case because no material has been brought on record by the AO to show that in respect of purchases made by the assessee from the proprietorship concern, the rates at which they were purchased were not comparable with the market value. Section 80-IA(10) would not apply because no material has been brought on record by the AO to demonstrate any arrangement. The AO has accepted the trading results of proprietary concern in the order u/s 143(3) of the Act dated 27.12.2011 copy of which is filed at page 33 of the paper book for AY 2009-10 under appeal.

The AO of the assessee firm also accepted the trading results on the same facts in subsequent AY 2010-11, u/s 143(3) of the Act vide order dated 27.12.2012 copy of which is filed at page 28 of the paper book. Ld. Counsel for the assessee, therefore, submitted that Ld. CIT(A) correctly deleted the addition.

6. We have considered the rival submission and perused the material on record.

7. It is not in dispute that assessee is 100% EOU and located in SEZ area of Moradabad. It is also not in dispute that assessee is entitled for exemption u/s 10AA of the Act. It is also not in dispute that assessee followed norms of Special Economic Zone Act for purchasing and exporting the goods. The assessee explained that it can only import its raw material through suppliers/small time manufacture/artisan who are registered with DGFT, EPCH. The proprietorship concern of the partner has fulfilled such conditions, therefore, there was nothing wrong, if assessee made purchases from the proprietorship concern. No material has been brought on record by the AO to show that in respect of purchases made by the assessee firm from the proprietorship concern the rates at which they were purchased were not comparable with the market value. No material has been brought on record by the AO to prove, if there was any arrangement to evade taxes. The assessee explained before the AO that the detailed chart of GP and NP would establish that this year 10% NP rate is higher on account of more exchange rate difference

received hence after considering this factor the rest of the difference would remain negligible. The submission of the assessee has not been rebutted through any evidence or material on record. The AO in the case of the proprietorship concern in the assessment order u/s 143(3) for assessment year under appeal i.e. 2009-10 accepted the trading results and did not doubt the transactions between the proprietorship concern and the assessee firm. The assessee firm explained the reasons why purchases have been made from the proprietorship concern. No specific defects have been pointed out in maintenance of the books of accounts by the assessee. The assessee also explained that it has purchased semi finished material from the proprietorship concern upon which improvements have been done by the assessee firm and rates are verifiable, which were according to the market rate. The assessee also explained that there is a difference in the activities of the proprietorship concern and the assessee firm. Therefore, their operation and activities are materially different and hence, two units are incomparable. The AO of the assessee firm in subsequent AY 2010-11 examining the same issue in the order u/s 143(3) of the Act accepted the trading results of the assessee, copy of the order is also placed on record. Therefore, Revenue-Department shall have to maintain Rule of consistency in their approach while accepting the book result of the assessee. It, therefore, appears that the AO without bringing any material on record made the addition merely on surmises and guess work. Therefore, there was no justification to reject the book results of

the assessee. The Ld. CIT(A) rightly considered and appreciated the facts and material on record for the purpose of deleting the addition. Since, assessee is admittedly entitled for deduction u/s 10AA of the Act, the AO without any justification tried to make the addition considering the addition as income from non special economic zone business without bringing any evidence against the assessee as to how the assessee was doing business activities outside the SEZ area. The findings of the AO are without any basis and without bringing any evidence on record. Since, no discrepancy has been pointed out in maintenance of the books of accounts of the assessee and the documents produced on record, therefore, there was no justification to make the aforesaid addition against the assessee. Considering the evidences and material on record in the light of findings or facts recorded by the Ld. CIT(A), we are of the view section 80IA(8)&(10) are not applicable to the facts and circumstances of the case. There is no infirmity pointed out in the order of Ld. CIT(A). Ld. DR merely contended that matter may be restored to the file of AO for fresh assessment. However, no material has been brought on record or to make any specific allegation against the findings of the Ld. CIT(A), therefore, there is no need to restore the matter back to the file of AO for fresh assessment. In this view of the matter, we do not find any justification to restore the matter to the file of AO for fresh assessment. There is no merit in departmental appeal. The same is, accordingly, dismissed.

8. In the result, the departmental appeal is dismissed.

Order pronounced in the open court.

Sd/-

Sd/-

(L.P. SAHU)
ACCOUNTANT MEMBER

(BHAVNESH SAINI)
JUDICIAL MEMBER

Dated: 01.01.2019

*Kavita Arora

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

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ASSISTANT REGISTRAR
ITAT NEW DELHI

