

**IN THE INCOME TAX APPELLATE TRIBUNAL  
“A”BENCH: BANGALORE**

**BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT  
AND  
SHRI B.R. BASKARAN, ACCOUNTANT MEMBER**

ITA Nos.1538 & 1539/Bang/2018
Assessment Years: 2012-13 & 2013-14

M/s. Kariganur Mineral Mining Industry Mine Owners, Embitee Complex Bellary Road Near Circle Hosapete-583 201  <b>PAN NO :AADFK0816D</b>	<b>Vs.</b>	ACIT Circle-1 Bellary
<b>APPELLANT</b>		<b>RESPONDENT</b>

<b>Appellant by</b>	:	Shri Siva Prasad Reddy, A.R.
<b>Respondent by</b>	:	Shri Sumer Singh Meena, D.R.

Date of Hearing	:	09.02.2022
Date of Pronouncement	:	22.02.2022

**ORDER**

**PER B.R. BASKARAN, ACCOUNTANT MEMBER:**

Both the appeals of the assessee are directed against the orders passed by Ld CIT(A), Gulbarga and they relate to the assessment years 2012-13 and 2013-14. Since one of the issues urged in these two appeals is common in nature, these appeals were heard together and are being disposed of by this common order, for the sake of convenience.

2. The common issue urged in both the appeals is whether the Ld CIT(A) was justified in confirming the addition of amount

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representing 10% of sale proceeds deducted by the Monitory committee from e-auction sale of mineral stock belonging to the assessee and which was contributed to Special Purpose Vehicle, as per the direction given by Hon'ble Supreme Court. In AY 2012-13, the assessee has raised two other issues mentioned below:-

(a) Difference in stock valuation – Rs.90,58,713/-

(b) Addition of closing stock -- Rs.12,75,26,801/-

3. The facts relating to the case are discussed in brief. The assessee is a partnership firm and is engaged in the business of extraction of iron ore by taking lease of lands from Government.

3.1 Before proceeding to the common issue urged before us, it is necessary to discuss about the back ground that led to scrutiny of mining operations carried out by various lessees of mines. These details have been culled out from the order dated 18-04-2013 passed by Hon'ble Supreme Court in the same of Samaj Parivartana Samudaya & Ors vs. State of Karnataka (Writ Petition (Civil) No.562 of 2009). The decision rendered by Hon'ble Supreme Court in this case has resulted in making certain additions by the Assessing officer. Hence, it is imperative to understand and appraise the decision rendered by Hon'ble Supreme Court.

3.2 Over exploitation or rampant mining in the State of Karnataka, particularly in the district of Bellary, was engaging the attention of the State Government from time to time. Not satisfied with the investigation carried in the State of Karnataka, a NGO named M/s Samaj Parivartana Samudaya had instituted a writ petition before Hon'ble Supreme Court under Article 32 of the Constitution complaining of little or no coercive action on the part of the State; seeking Hon'ble Supreme Court's intervention in the matter and

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specifically praying for certain reliefs. The writ petition was entertained and a Committee called “Central Empowered Committee” (CEC) was formed and it was asked to submit a report on the allegations of illegal mining in the Bellary region of the State of Karnataka. The initial reports submitted by CEC indicated large scale illegal mining at the cost and to the detriment of the environment. Hence, vide its order dated 29-7-2011, the Hon’ble Supreme Court imposed complete ban on mining in the district of Bellary.

3.3 The details of various orders passed by Hon’ble Supreme Court in this regard are given below:-

- *Hon’ble Supreme Court by order dated 29/07/2011 passed in GOI vs. Obulapuram Mining Co. Pvt.Ltd., reported in (2011) 12 SCC 491, suspended all mining and transportation activities in areas admeasuring approximately 10,868 ha, pertaining to district of Bellary.*
- *Subsequently, by order dated 26/08/2011 passed in SamajParivartanaSamudaya vs state of Karnataka, reported in (2013) 8 SCC 209, Hon’ble Apex Court extended ban to Tumkur and Chitradurga mines, based upon a report filed by Central Empowered Committee (hereinafter referred to as CEC). Hon’ble Apex Court directed Ld.Amicus Curiae to submit quantity which could be released from existing stock of 25,000,000 Ton of iron ore, subject to reclamation and rehabilitation plans being submitted. This was pursuance to plea raised by Association of Steel Industry and other affected parties.*
- *On 23/09/2011 Hon’ble Apex Court was appraised by CEC report dated 01/09/2011, regarding modalities of sale of existing stock of iron ore through E-Auction, sale proceeds to*

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be deposited in nationalized bank. It was submitted in the report that, where there is no illegal mining, 80% of sale proceeds to be released and 20% to be retained. A Monitoring Committee (MC) was to be constituted to supervise and control E-Auction, size of lot, transportation etc. It was submitted therein that, MC would utilise sale proceeds for payment of royalty, taxes etc.

- Subsequently, a plea by Karnataka Iron and Steel Manufacturers Association was raised regarding shortage of supply of minerals due to suspension of mining activity, before *Hon'ble Apex Court*. The association also sought for a direction to reopen Category 'A' mines.
- Thereafter, by order dated 03/09/2012 *Hon'ble Apex Court* in case of *SamajParivartanaSamudaya vs state of Karnataka*, reported in (2013) 8 SCC 219 approved report dated 29/08/2012 filed by CEC. *Hon'ble Apex Court* ordered for reopening of category 'A' mines, and vacated order dated 29/07/2011 passed in case of *GOI vs. Obulapuram Mining Co. Pvt.Ltd., (supra)* and order dated 26/08/2011 in case of *SamajParivartanaSamudaya vs State of Karnataka (supra)*.
- Thereafter, by order dated 28/09/2012, CEC filed detailed report dated 03/02/2012, categorising mines into 'A', 'B' and 'C', depending on various types of violations by mining lessee.

3.4 The reports also indicated **large scale encroachment into forest areas** by leaseholders and ongoing mining operations in such areas without requisite statutory approval and clearances. Hence a Joint Team was constituted by Hon'ble Supreme Court by order dated 6.5.2011 to determine the boundaries of initially 117 mining leases, which number was subsequently extended to 166 by inclusion of the mines in Tumkur and Chitradurga districts. The

CEC submitted its final report dated 3.2.2012, which made two significant recommendations:-

(A) Categorisation of mines into three categories, i.e., “A”, “B” and “C” on the basis of extent of encroachment in respect of **mining pits** and **over burden dumps** determined in terms of percentage qua the total lease area.

(B) Conditions subject to which reopening of the mines and resumption of mining operations were to be considered by the Court.

A set of modified recommendations along with a set of detailed guidelines for preparation and implementation of Reclamation and Rehabilitation Plans (R & R) were also submitted to the Hon'ble Supreme Court by CEC on 13.3.2012.

3.5 The CEC categorised the mines into “A”, “B” and “C” on the following basis:-

(a) The Category “A” comprises of (a) working leases wherein no illegality/marginal illegality have been found and (b) non-working leases wherein no/marginal illegalities have been found.

(b) The Category “B” comprises of

(a) mining leases wherein illegal mining by way of (i) **mining pits** outside the sanctioned lease areas have been found to be **upto 10%** of the lease areas and/or (ii) **over burden/waste dumps** outside the sanctioned lease areas have been found to be **upto 15%** of the lease areas and

(b) leases falling on interstate boundary between Karnataka and Andhra Pradesh and for which survey sketches have not been finalised.

(c) The Category “C” comprises of leases wherein (i) the illegal mining by way of (a) **mining pits** outside the sanctioned

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lease area have been found to be **more than 10%** of the lease area and/or (b) **over burden/waste dumps** outside the sanctioned lease areas have been found to be **more than 15%** of the lease areas and/or (ii) the leases found to be involved in flagrant violation of the Forest (Conservation) Act and/or found to be involved in illegal mining in other lease areas.

3.6 The Hon'ble Supreme Court also approved sale of iron-ore through e-auction and it was further held that the e-auction shall be conducted by the Monitoring Committee (MC) constituted by Hon'ble Supreme Court. However, **the quantity to be put up for e-auction, its grade, lot sizes, its base/floor price and the period of delivery will be decided/provided by the respective lease holders.** It was also held that the Monitoring Committee may permit the lease holders to put up for e-auction the quantities of iron ore planned to be produced in subsequent months.

3.7 The categorisation of mines into "A", "B" and "C" had following financial impact:-

(A) From sale proceeds realised by MC on sale of iron-ore belonging to Category A mining leases, 10% shall be retained by the MC. Balance 90% shall be paid to the concerned lessees. The above said 10% shall be transferred to Special Purpose Vehicle (SPV).

(B) From the sale proceeds realised by MC on sale of iron-ore belonging to Category B mining leases, following amounts shall be deducted retained by MC:-

(a) 15% of sale proceeds to be transferred to SPV.

(b) Compensation for illegal mining and illegal dumping computed

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- (i) @ Rs.5.00 crores per Ha of the area found by the Joint Team to be under illegal mining pit; and
- (ii) @ Rs.1.00 crore per Ha of area for illegal mining by way of over burden dump(s), road, office etc outside the sanctioned lease area.

(c) The estimated cost of Reclamation and Rehabilitation Plans (R & R plans). For this purpose, a Guarantee money for implementation of R & R plans shall be collected.

Category B lessees have to deposit a Guarantee money for implementation of R & R Plans in the respective sanctioned lease areas. On full implementation of the R & R Plans to the complete satisfaction of the CEC and subject to the approval by Hon'ble Supreme Court, the guarantee money would be refundable to the lease holder. It was also stated that the lessees shall be liable to pay additional amount, if the R & R Plan expenditure exceeded the estimates.

(C) In respect of mining leases falling under Category C:-

- (a) such leases are cancelled/determined on account of the leases having been found to be involved in substantial illegal mining outside the sanctioned lease areas
- (b) the entire sale proceeds of the existing stock of the iron ore of these leases should be retained by the MC and
- (c) the implementation of the R & R plan should be at the cost of the lessee.

4. Now we shall turn to the facts relating to the issue urged before us. The mines owned by the assessee herein have been categorised as "A" category mines. Hence 10% of sale proceeds has

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been deducted by Monitoring Committee during the years under consideration as detailed below:-

Assessment year	2012-13	:	Rs.3,47,45,617/-
Assessment year	2013-14	:	Rs.1,22,93,688/-

The assessee claimed deduction of above said payments as expenditure. However, the AO was of the view that the amount retained by MC as per the proposal approved by Hon'ble Supreme Court is in the nature of "appropriation of profit" for adjusting it against the penalty and other liabilities. Accordingly, the AO took the view that the above said payments cannot be said to be incurred wholly and exclusively for the purpose of business within the meaning of provisions of sec.37 of the Act. Hence the AO proposed to disallow the above said claim of the assessee in both the years. However, the assessee contended that the above said amounts have not been received by it and hence the same should not be considered in its hands.

4.1 The AO, however, did not accept the contentions of the assessee. The AO gave following reasoning in this regard in AY 2013-14:-

(a) Entire sale proceeds as per E-auction bit sheets/invoices has to be assessed to tax as trading receipts, since retention money is part of sale proceeds only. Hence it constitutes income in the hands of the assessee. Since the assessee is following mercantile system of accounting, it cannot be taxed on receipt basis.

(b) The amount retained by CEC/MC, as per directions of the Supreme Court on behalf of the assessee, which is given to the Special Purpose Vehicle (SPV) is on account of penal and

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other liabilities for contravention of laws. Hence it cannot be allowed u/s 37(1) of the Act.

(c) SPV established for Social economic development of the mining area is nothing but relating to Corporate Social responsibility only. Hence it is only appropriation of profits and hence it cannot be said to have been incurred for the purpose of business or earning the profits.

(d) The AO placed his reliance on the following case laws:-

- (i) CIT vs. KCP Limited (245 ITR 421)(SC)
- (ii) G. Padmanabha Chettiar & Sons (182 ITR 1,5)(Mad)
- iii) Reform Flour Mills P Ltd vs. CIT (132 ITR 184, 196)(Cal.)
- (iv) CIT vs. A. Krishnaswamy Mudaliar & Others (53 ITR 122)(SC)

Accordingly, the AO added the above said amounts in the total income of the assessee of respective years. The Ld CIT(A) also confirmed the same.

4.2 Before us, the Ld A.R placed his reliance on the decision rendered by the Co-ordinate bench in the case of M/s Veerabhadrappe Sangappa & Co vs. ACIT (ITA No.1054/Bang/2019 dated 08-12-2020 and also the decision rendered by another co-ordinate bench in the case of M/s Ramgad Minerals & Mining Ltd vs. ACIT (ITA No. 1270 & 1271/Bang/2019 dated 04-11-2020. The Ld A.R submitted that, in the above said cases, it has been held by the Tribunal that the amount of 10%/15% as the case may be retained by the Monitory committee is assessable as trading receipts, but allowable as business expenditure, net effect of which is NIL addition. Accordingly he submitted that the addition made by the AO in both the years is liable to be deleted.

4.3 The Ld D.R, however, placed his reliance on the orders passed by Ld CIT(A).

4.4 We heard the parties on this issue and perused the record. We notice that identical issue has been examined by the co-ordinate benches in the cases relied upon by the assessee. For the sake of convenience, we extract below the relevant observations made by the co-ordinate bench in the case of M/s Veerabhadrapa Sangappa & Co (supra):-

*7.10.4. With this background, we once again refer to and rely on observations by Hon'ble Supreme Court in case of CIT vs Sitaldas Tirathdas (supra). Hon'ble Supreme Court laying down following principal referred to various rulings that illustrated aspects of diversion of income by overriding title.*

*“These are the cases which have considered the problem from various angles. Some of them appear to have applied the principle correctly and some, not. But we do not propose to examine the correctness of the decisions in the light of the facts in them. In our opinion, the true test is whether the amount sought to be deducted, in truth, never reached the assessee as its income. Obligations, no doubt, there are in every case, but it is the nature of the obligation which is the decisive fact. There is a difference between an amount which a person is obliged to pay out of his income and an amount which by the nature of the obligation cannot be said to be a part of the income of the assessee. Whereby the obligation income is diverted before it reaches the assessee, it is deductible but where the income is required to be applied to discharge an obligation after such income reaches the assessee the same consequence in law does not follow. It is the first kind of payment which can truly be excused and not the second. The second payment is merely an obligation to pay another portion of one's own income which has been received and essence applied. The first is a case in which the income never reaches the assessee, who, even if he were to collect it, does so, not as part of his income but for and on behalf of the person to whom it was payable.”*

*Emphasis Supplied*

*7.10.5. Applying, thin line of difference interpreted by Hon'ble Supreme Court to present facts, we are of the opinion that, contribution to SPV account, cannot be considered to be diversion of income. This is because, we have already held while deciding ground 2.1 and 2.2 hereinabove, that entire sale proceeds accrued to assessee, and it is only due to direction of Hon'ble Supreme Court that such amount was contributed to SPV account,*

for which assessee was to authorise CEC/MC in relevant paragraph 11(III) refer to and relied by Ld.CIT DR.

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**7.10.8.** We note that co-ordinate Hyderabad bench of Tribunal in NMDC (supra) was the case of Category 'A' wherein it was allowed as expenditure by observing as under:

"2. Brief facts of the case are that the assessee-company, a Public Sector Undertaking, engaged in the business of 'mining of iron ore diamonds; and generation and sale of wind power', filed its return of income for the relevant Assessment Years 2013-14 and 2014-15 both under the normal provisions as well as u/s 115JB of the Act for the relevant AYs. During the assessment proceedings u/s 143(3) of the Act, the A.O. observed that the assessee-company is carrying out mining activity in India and particularly in Karnataka and that the Hon'ble Supreme Court of India took note of the large scale illegal mining activity carried on by various companies in Karnataka at the cost or detriment of environment and delivered their judgment on 18.04.2013 levying appropriate charges on the leaseholders. A.O. also observed that the Hon'ble Supreme Court, based on the extent of illegal mining, classified the mining leases into three categories viz., Category "A", "B" and "C" and that the assessee is falling in Category-B in respect of Donimali Complex and that in their order, the Apex Court observed that before consideration of any resumption of mining operations by Category-B leaseholders, each of the lease holder must pay compensation for the areas under illegal mining pits outside the sanctioned area at the rate of Rs. 5 Crs per hectare and for illegal overburden for at the rate of Rs. 1 Cr per hectare. Further, A.O. observed that the said direction of the Apex Court was subject to the final determination of the notional loss caused by the illegal mining and illegal use of the land; and that the Hon'ble Supreme Court had directed that each of the leaseholder should pay a sum equivalent to 15% of the sale proceeds of its iron ore sold through the Monitoring Committee. In accordance with the said direction, the assessee made payment of Rs. 337.13 Crs towards contribution for the Special Purpose Vehicle and the sum of Rs. 68.66 Crs towards penalty / compensation for encroachment of the mining area beyond the sanctioned / leased area. The A.O. observed that the total of the above payment of Rs. 405.79 Crs was punitive in nature and accordingly sought to disallow the same by issuance of a show-cause notice.

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4. The A.O. however did not accept the assessee's explanation and held that the assessee, being a Category-B leaseholder, has been directed to make the payment for infringement of MMDR Act and other allied laws. Therefore, he observed that the payment of Rs. 405.79 Crs is punitive in nature and brought it to tax.

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10. Thus, from the table reproduced above, it is seen that the assessee has been classified as Category-'A' whereas the Assessing Officer has considered the assessee as Category-'B' company. The Hon'ble Supreme Court has clearly indicated that Category-A comprises of (i) 'working leases' wherein no illegality / marginal illegality have been found and (ii) 'non-working leases' wherein no marginal / illegalities have been found, whereas Category-B comprises of (i) mining leases wherein illegal mining is 10% to 15% of the sanctioned lease areas. However, CEC had recommended that both "A" and "B" categories may be allowed to resume the mining activity subject to the payment of penalty / compensation decided by the Court. Thus, according to the assessee, the said expenditure is nothing but a payment which was required to be made without which the assessee could not have carried on the mining activities and therefore, it is a 'business expenditure'. Since the CEC had categorised the assessee as a Category-A company and the Hon'ble Supreme Court has accepted the said categorization, there would have been marginal illegalities committed by the assessee and the compensation / penalty as directed by the Hon'ble Supreme Court is only to compensate the Government for the loss of revenue from such mining or marginal illegalities and not as a penalty. Though the nomenclature given is "penalty" it is not for infraction or violation of any law to hold it to be punitive in nature, as presumed by the Assessing Officer. Learned Counsel for the Assessee placed reliance on various case law, particularly the decision of the Coordinate Bench of the ITAT, Kolkata in the case of [Essel Mining & Industries Ltd vs. Addl. CIT](#) (ITA No. 352/Kol/2011 and others, dated 20.05.2016); [ACIT vs. Freegade & Co. Ltd](#) (ITA No.934/Kol/2009, dated 05.08.2011) and also the decision of the Hon'ble Calcutta High Court in the case of [ShyamSel Ltd vs. DCIT](#) (72 Taxmann.com 105) (Cal.). On going through the said decisions, we find that the Hon'ble Calcutta High Court has considered the case of an assessee who failed to install Pollution Control Device within factory premise within prescribed time and that the assessee had to pay Rs. 12.50 lakh for compensating damage to environment and the same was recovered by State Pollution Control Board on the principle of 'polluter pays' and the A.O. had treated it as penalty and did not allow the same as business expenditure. The Hon'ble High Court had taken note of the fact that the assessee's business was not illegal and that compensation was paid because of its failure to install pollution control device within prescribed time and therefore, such payment was undoubtedly for the purpose of business and in consequence of business carried on by the assessee and was thus covered by [section 37](#) of the Act. For coming to this conclusion, Hon'ble High Court has also considered the judgment of the Hon'ble National Green Tribunal in the case of [State Pollution Control Board vs. Swastik Ispat \(P.\) Ltd](#) wherein at para 38 of the judgment the Tribunal held as under:-

"Being punitive is the essence of 'penalty'. It is in clear contradistinction to 'remedial' and / or 'compensatory'. 'penalty' essentially has to be for result of a default and imposed by way of

*punishment. On the contrary, 'compensatory' may be resulting from a default for the advantage already taken by that person and is intended to remedy or compensate the consequences of the wrong done. For instance, if a unit has been granted conditional consent and is in default of compliance, causes pollution by polluting a river or discharging sludge, trade effluent or trade waste into the river or on open land causing pollution, which a Board has to remove essentially to control and prevent the pollution, then the amount spent by the Board, is thus, spent by encashing the bank guarantee or is adjusted thread and this exercise would fall in the realm of compensatory restoration and not a penal consequence. In gathering the meaning of the word 'penalty' in reference to a law, the context in which it is used is significant."*

*11. Applying this ratio to the facts of the case before us, we find from para 43 of the Hon'ble Supreme Court's order reproduced above that the condition of payment for resuming the mining activity by Categories 'A' & 'B' companies is to not to punish the companies for any violation of law but is to ensure scientific and planned exploitation of mineral resources in India. Further the Hon'ble Supreme Court had directed as under:-*

*"(X) Out of the 20% of sale proceeds retained by the Monitoring Committee in respect of the cleared mining leases falling in "Category- A", 10% of the sale proceeds may be transferred to the SPV while the balance 10% of the sale proceeds may be reimbursed to the respective lessees. In respect of the mining leases falling in "Category-B", after deducting the penalty / compensation, the estimated cost of the implementation of the R & R Plan, and 10% of the sale proceeds to be retained for being transferred to the SPV, the balance amount, if any may be reimbursed to the respective lessees;"*

*The fact that the compensation is proportionate to area of illegal mining outside the leased area and that the assessee has paid the proportionate compensation for mining in the areas outside the sanctioned area allotted to it and that 10% of sum is to be transferred to SPV and the balance 10% is to be reimbursed to the respective lessees, according to us, proves that it is a payment made as 'compensation' for extra mining, without which the assessee could not have resumed its activities. Therefore, we are inclined to accept the contention of the assessee that it is compensatory in nature and is a 'business expenditure' and is allowable u/s 37(1) of the Act. Thus, Grounds No.2 and 3 raised by the assessee are allowed."*

**7.10.9.** *We also notice that the co-ordinate Bangalore bench of Tribunal has also considered identical issue in the case of Ramgad Minerals & Mining Ltd (ITA No.1270 & 1271/B/2019 dated 04-11-2020) being*

Category 'B', an identical addition made by Ld.AO was held to be allowable as expenditure with following observations:-

**“7.8.9.** In present appeals, only issue raised for our consideration is in respect of 15% contribution made to SPV for assessment year 2013-14 and 2014-15; and issue in respect of R&R expenses incurred during assessment year 2013 – 14. First of all, we summarise objections of Ld.AO as in respect of SPV expenses as under:-

(a) This is one of the objections of the AO that the SPV Expenses is not allowable because it is not compensation but it is penal in nature for contravention of law as observed by him in para 4.3 of the assessment order for AY:2013-14.

(b) Second objection of the Ld.AO is contained in para 4.9 of the assessment order for AY:2013-14 and as per the same, this is the objection of Ld.AO that the said SPV is nothing but CSR Expenses only and therefore not allowable.

(c) Third objection of Ld.AO is also contained in para 4.9 of the assessment order for AY:2013-14 and as per the same, this is the objection of the Ld.AO that the said SPV is not allowable u/s 37 (1) as it was not incurred by the assessee wholly and exclusively for the purpose of business.

(d) In para 4.8 of the assessment order for AY:2013-14, Ld.AO is stating this that SPV rate is 10% in category 'A' Mines but 15% in Category 'B' Mines and this extra 5% in Category 'B' Mines is for various violations and illegal mining and even after this observation, he finally held in the same para that whole SPV Expenses of 15% is not allowable.

**7.8.10.** Ld.AO observed that, these SPV were deducted pursuant to directions of Hon'ble Supreme Court (supra) by order dated 18/04/2013, wherein, it was directed that, sum so paid towards SPV charges should be exhaustively and exclusively used to undertake socio economic and infrastructure development, afforestation, soil and biodiversity conservation and for ensuring inclusive growth of the area surrounding mining leases.

**7.8.11.** Ld.AO further observed that these payments are nothing but appropriation of profits earned by assessee that cannot be said to have incurred for purpose of business or earning profits. Accordingly, entire amount adjusted towards SPV was disallowed by Ld.AO. Ld.AO was of opinion that entire sale proceeds as per E auction bid Sheets/invoices were to be assessed as trading receipts. The amount retained by CEC/monitoring committee as per directions of Hon'ble Supreme Court, on behalf of assessee for SPV purposes, was on account of damages and loss caused to environment due to contravention of law, and therefore, cannot be allowed as deduction out of sale proceeds, even after accrual of such liability. Ld.AO was of opinion that, even in Category 'A' mines, there was marginal

*illegality found by CEC, because of which 10% of contribution was attributed out of sale proceeds to the SPV.*

*7.8.12. On careful reading of decision of Hon'ble Supreme Court dated 18/04/2013, it is clear that 15% contribution to SPV account was guarantee payment for implementing of R & R plan, which would be deducted from sale proceeds. This was one of the conditions for resuming mining operations under Category 'B'.*

*We refer to and rely on observations by Hon'ble Supreme Court in case of CIT vs SitaldasTirathdasreported in(1961) 41 ITR 367.Hon'ble Supreme Court laying down following principal referred to various rulings that illustrated aspects of diversion of income by overriding title.*

*“These are the cases which have considered the problem from various angles. Some of them appear to have applied the principle correctly and some, not. But we do not propose to examine the correctness of the decisions in the light of the facts in them. In our opinion, the true test is whether the amount sought to be deducted, in truth, never reached the assessee as its income. Obligations, no doubt, there are in every case, but it is the nature of the obligation which is the decisive fact. There is a difference between an amount which a person is obliged to pay out of his income and an amount which by the nature of the obligation cannot be said to be a part of the income of the assessee. Whereby the obligation income is diverted before it reaches the assessee, it is deductible but where the income is required to be applied to discharge an obligation after such income reaches the assessee the same consequence in law does not follow. It is the first kind of payment which can truly be excused and not the second. The second payment is merely an obligation to pay another portion of one's own income which has been received and essence applied. The first is a case in which the income never reaches the assessee, who, even if he were to collect it, does so, not as part of his income but for and on behalf of the person to whom it was payable.”*

*Emphasis Supplied*

*7.8.13. In the present case, we note that 15% of sale proceeds was payable to SPV account after it accrued to assessee and the fact that, assessee was obliged to part with such portion of income, by virtue of directions of Hon'ble Supreme Court, as a precondition to resume mining operations under Category 'B'. At this juncture, we also emphasise that, but for the intervention by Hon'ble Supreme Court, assessee would not have contributed 15% to SPV account for implementation of reclamation and rehabilitation scheme on its own, as there was no statutory requirement to do so under relevant statutes that regulate mining activities.*

*7.8.14. Hon'ble Supreme Court has been very clear regarding the types of payments that needs to be recovered from lessee's under Category 'B', from the sale proceeds as well as otherwise. All the payments form part of R&R plan for recouping and rehabilitating the environment. Certain*

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*payments are onetime payment and some others are recurring depending upon the sale of iron ore sold in the name of each licensee or depending on the need for rehabilitation.*

*7.8.15. In our view, contributing 15% to SPV account on account of Category 'B', would be application of income, and therefore, should be considered as expenditure incurred for carrying out its business activity. This we hold so, for the reason that, contributions determined by Hon'ble Supreme Court are in the nature of guarantee payment necessary for resuming mining activity. We also note that, alleged sum in these grounds are for implementation of R&R Plans in respective sanctioned lease areas held by assessee, where illegal mining activities or which were used for illegal overburden dumps, roads, offices etc., beyond sanctioned lease area were carried out. Here, we also note that, Hon'ble Supreme Court directed CEC to refund any leftover guarantee money, after completion of implementation of R& R plan, subject to satisfaction of CEC and approval by Hon'ble Supreme Court. For this peculiar reason, amount so contributed towards SPV being 15% of sale proceeds, under Category B, cannot be treated as penal in nature. We, therefore, reject observations of authorities below that, such sum having contributed by assessee fall within ambit of explanation 1 to section 37 (1) of the Act."*

4.5 The Ld D.R, however, contended that the decision rendered in the case of NMDC Ltd (supra) cannot be relied upon by the assessee. He submitted that NMDC Ltd is a public sector undertaking and further, there is no allegation of illegalities. He also submitted that the Hyderabad bench of Tribunal has taken the view that these payments are not punitive in nature, but compensation for scientific exploitation of minerals. However, the Ld D.R contended that these amounts have been collected from the assessees, since they have caused damage to the environment and hence it is penal in nature.

4.6 The Hyderabad bench of Tribunal has also noticed that NMDC Ltd falls under "Category A". There is no dispute about the same. However, the CEC has recommended that M/s NMDC Ltd shall be liable to deposit penalty/compensation as payable for the mining leases falling in "Category B". The said recommendation was accepted by Hon'ble Supreme Court and hence NMDC Ltd has

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paid compensation @ 5.00 crores & 1.00 crores and also deduction from sale proceeds was made @ 15%. In any case, the question is here is about the nature of such payments.

4.7 We notice that, in the case of NMDC Ltd (supra), Hyderabad bench of Tribunal has relied upon the decision rendered by Hon'ble Kolkata High Court in the case of Shyam Sel Ltd (supra) and also the decision rendered in the case of State Pollution Control Board vs. Swastik Ispat (P) Ltd (supra). In both the cases, the payment made by an assessee to the Pollution Control Board in order to take remedial action in respect of the pollution caused by the assessee would be compensatory in nature.

4.8 We have earlier noticed that the CEC, vide its report dated 3-2-2012 and 13-3-2012 had made certain recommendations to the Hon'ble Supreme Court. The Hon'ble Supreme Court has incorporated those recommendations in Paragraph 7 (Page 164 to 171 of its order reported in (2013)(8 SCC 154). The CEC had made following recommendation with regard to setting up of Special Purpose Vehicle, transfer of funds collected from all lease holders under various heads, the purpose of utilisation of said funds etc.

*“(IX) A Special Purpose Vehicle (SPV) under the Chairmanship of Chief Secretary, Government Karnataka and with the senior officers of the concerned Departments of the State Government as Members may be directed to be set up for the purpose of taking various ameliorative and mitigative measures in Districts Bellary, Chitradurga and Tumkur. The additional resources mobilized by (a) allotment/ assignment of the cancelled mining leases as well as the mining leases belonging to M/s. MML, (b) the amount of the penalty/ compensation received/ receivable from the defaulting lessee, (c) the amount received/ receivable by the Monitoring Committee from the mining leases falling in “Category- A” and “Category-B”, (d) amount received/ receivable from the sale proceeds of*

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*the confiscated material etc., may be directed to be transferred to the SPV and used exclusively for the socio- economic development of the area/local population, infrastructure development, conservation and protection of forest, developing common facilities for transportation of iron ore (such as maintenance and widening of existing road, construction of alternate road, conveyor belt, railway siding and improving communication system, etc.).A detailed scheme in this regard may be directed to be prepared and implemented after obtaining permission of this Hon'ble Court;”*

The Hon'ble Supreme Court @ 176 of its order has made following observations with regard to SPV:-

*“By order dated 28-09-2012, this Court had constituted a Special Purpose Vehicle (for short “SPV”) on the suggestion of the learned amicus curiae. The purpose of constitution of the SPV, it may be noticed, is for taking of ameliorative and mitigative measures as per the “Comprehensive Environment Plans for Mining Impact Zone (CPEMIZ) around mining leases in Bellary, Chitradurga and Tumkur. By order dated 28-09-2012, the Monitoring Committee was to make available the payments received by it under different heads of receivables to the SPV”*

4.9 The Hon'ble Supreme Court has observed as under in respect of Reclamation and Rehabilitation Plans (R & R Plans) at page 168:-

*“8. As previously noticed, the CEC in its Report dated 13.3.2012 had set out in detail the objectives of the Reclamation and Rehabilitation (R&R) plans and the guidelines for preparation of detailed R & R plans in respect of each mining lease. The origins of the idea (R & R plans) are to be found in an earlier Report of the CEC dated 28.7.2011. As the suggestions of the CEC with regard to preparations of R & R plans for each mine is crucial to scientific and planned exploitation of the mineral resources in question it will be necessary for us to notice the said objectives and the detailed*

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*guidelines which are set out below. In this connection it would be worthwhile to take note of the fact that the guidelines in question have been prepared after detailed consultation with different stakeholders including the Federation of Indian Mineral Industries (FIMI) which claims to be the representative body of the majority of the mining lessees of the present case.*

## **II. BROAD OBJECTIVES/PARAMETERS OF R&R PLANS**

*8. The broad objectives/parameters of the R&R Plans would be:*

- i) to carry out time bound reclamation and rehabilitation of the areas found to be under illegal mining by way of mining pits, over burden/waste dumps etc. outside the sanctioned areas;*
- ii) to ensure scientific and sustainable mining after taking into consideration the mining reserves assessed to be available within the lease area;*
- iii) to ensure environmental friendly mining and related activities and complying with the standards stipulated under the various environmental/mining statutes e.g. air quality (SPM, RPM), noise/vibration level, water quality (surface as well as ground water), scientific over burden/waste dumping, stabilization of slopes and benches, proper stacking and preservation of top soil, sub grade mineral and saleable minerals, proper quality of internal roads, adequate protective measures such as dust suppression/control measures for screening and crushing plants, beneficiation plants, provision for retention walls, garland drains, check dams, siltation ponds, afforestation, safety zones, proper covering of truck, exploring possibility of back filling of part of over burden/waste dumps in the mining pits, sale/beneficiation of sub grade iron ore, water harvesting, etc.*
- iv) for achieving (ii) and (iii) above, fixation of permissible annual production; and*
- v) regular and effective monitoring and evaluation.*

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The Hon'ble Supreme Court has also recorded lease wise R & R Plans in continuation of the above said observations.

4.10 The Hon'ble Supreme Court has accepted the recommendations of CEC with the following observations at page 194:-

*“52. The conditions subject to which Category ‘A’ and ‘B’ mines are to be reopened and the R&R Plans that have been recommended as a precondition for reopening of Category ‘B’ mines are essentially steps to ensure scientific and planned exploitation of the scarce mineral resources of the country. **The details of the preconditions and the R&R plans have already been noticed and would not require a repetition. Suffice it would be to say that such recommendations are wholesome and in the interest not only of the environment and ecology but the mining industry as a whole so as to enable the industry to run in a more organized, planned and disciplined manner.***

*53. FIMI was actively associated in the framing of the guidelines and the preparation of the R&R Plans. There is nothing in the preconditions or in the details of the R&R plans suggested which are contrary to or in conflict or inconsistent with any of the statutory provisions of the MMDR Act, EP Act and FC Act. In such a situation, while accepting the preconditions subject to which the Category ‘A’ and ‘B’ mines are to be reopened and the R&R plans that must be put in place for Category ‘B’ mines, we are of the view that the suggestions made by the CEC for reopening of Category ‘A’ and ‘B’ mines as well as the details of the R&R plans should be accepted by us, which we accordingly do. This will bring us to the most vital issue of the case, i.e., the future of the Category ‘C’ mines.”*

4.11 It can be noticed that all the amounts collected from the lessees under different categories are directed to be given to the SPV, which will in turn take various types of ameliorative and

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mitigative steps in the interest not only of the environment and ecology but the mining industry as a whole so as to enable the industry to run in a more organized, planned and disciplined manner. Under these set of facts, it cannot be said that these amounts are penal in nature. We notice that the Hyderabad bench of Tribunal in the case of NMDC Ltd (supra) came to the same conclusion by following the decision rendered by Hon'ble Kolkatta High Court in the case of ShyamSel Ltd (supra) and State Pollution Control Board vs. Swastik Ispat (P) Ltd (supra), wherein identical types of payments made to remedy the river pollution caused by the parties were held to be compensatory in nature. Hence the provisions of Explanation 1 to sec.37 will not apply to these payments. Hence, as held by Hyderabad bench of Tribunal in the case of NMDC Ltd (supra), these expenses are allowable as deduction u/s 37(1) of the Act.

4.12 Another important point we notice is that the recommendations made by CEC for making these payments have been made for the purpose of resuming the mining operations. The Hon'ble Supreme Court discusses these points at page 171 from paragraph 10 onwards. Hence there is merit in the submission of the Ld A.R that, without making these payments, the assessee could not have resumed the mining operations. Hence, these expenses are incidental to carrying on the business and hence allowable u/s 37(1) of the Act.

4.13 In view of the foregoing discussions and also following the decision rendered by the co-ordinate benches referred above, we hold that the above said amounts deducted from the sale proceeds is allowable as deduction u/s 37(1) of the Act. Accordingly, we set aside the order passed by Ld CIT(A) on this issue in both the years

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under consideration and direct the AO to delete the impugned addition made in both the years.

5. We shall take up the individual issues urged by the assessee in assessment year 2012-13. The first issue relates to rejection of claim for deduction of Rs.90,58,713/-, being the difference in valuation of stock made by the AO in assessment year 2009-10. The facts relating to the same are that the closing stock value as on 31.3.2009 pertaining to the assessment year 2009-10 was increased by Rs.90,58,713/- by the A.O., vide his assessment order dated 27.12.2011. While determining total income of AY 2012-13, the assessee claimed above said amount as deduction by increasing the value of opening stock as on 1.4.2011. The assessee was constrained to increase the opening stock as on 1.4.2011, since the assessment order for AY 2009-10 was passed on 27.12.2011, i.e., subsequent to the closure of accounting years relevant to assessment years 2010-11 & 2011-12.

5.1 The A.O. did not accept the claim and accordingly added the above said amount. The Ld. CIT(A) also confirmed the same.

5.2 We heard the parties on this issue and perused the record. We notice that the A.O. has disallowed the claim by observing that the assessee should have made the claim only in assessment year 2010-11, i.e., in the year succeeding to AY 2009-10. He also observed that the assessee has not reconciled closing stock quantity variation subsequently as on 31.3.2010 & 31.3.2011. Accordingly, the A.O. observed that the value of opening stock as on 1.4.2011 cannot be increased without disturbing the value of closing stock as on 31.3.2011. Accordingly, he rejected the claim for deduction of Rs.90,58,713/-. Before us, though the Ld. A.R. submitted that the

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increase in closing stock as on 31.3.2009 shall have cascading effect and hence, the deduction claimed by the assessee in assessment year 2012-13 should be allowed. However, we are of the view that the A.O. was right in observing that the difference in closing stock determined as on 31.3.2009 cannot straightaway have impact to the opening stock shown as on 1.4.2011, without modifying the closing stock as on 31.3.2010 and 31.3.2011. Further, the assessee has not furnished any material to show that the closing stock added by the A.O. in assessment year 2009-10 was still available with the assessee as on 31.3.2011. The closing stock as at the year end is determined on the basis of physical quantity available. Hence, without showing that the physical quantity which was added as on 31.3.2009 was available with the assessee as on 31.3.2011 over and above the quantity originally shown, it is not possible to increase the opening stock as on 1.4.2011. Accordingly, we confirm the disallowance made by the A.O. on this issue.

6. The last issue urged in AY 2012-13 relates to the addition of difference in closing stock of Rs.12,75,26,801/-. The AO noticed that the assessee has shown closing stock quantity at 41,199 tonnes. The AO noticed that the assessee has shown following quantities in the Annual return in Form No.H-1 filed before Department of Mines and Geology:-

	<i>From Open Cast working</i>	<i>Dump workings</i>
<i>Opening stock</i>	<i>1,93,559 Tonnes</i>	<i>5,80,830 Tonnes</i>
<i>Production</i>	<i>NIL</i>	<i>NIL</i>
<i>Closing stock</i>	<i>41,198 Tonnes</i>	<i>5,80,830 Tonnes</i>

The AO took the view that the assessee should have valued the Dump workings quantity of 5,80,830 tonnes also and should have included it in the closing stock value. The assessee submitted that

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the dump stock does not have market value and hence it was not considered for valuation of closing stock. The assessee also submitted that the physical inspection carried out by Department of Mines & Geology on 16.08.2012 showed that the dump stock was available to the extent of 50,184 MT only. The assessee further submitted that if any sale is made from out of dump stock and then the same will be offered to tax in the year of sale.

6.1 The AO did not accept the explanations of the assessee. He expressed the view that the physical inspection carried on by Department of Mines on 16-08-2012 does not mean that the assessee did not produce and did not have stock to the extent of 580830 MT as on 31.3.2012. The AO also expressed the view that the shortfall in the quantity shows that the assessee has sold the stock. Accordingly, the AO took the view that the value of 580830 MT should be included in the closing stock. Accordingly, the AO valued the above said quantity at Rs.12,75,26,801/- and accordingly increased the closing stock value, which has resulted in an addition of equal amount to the total income. The Ld CIT(A) also confirmed the same.

6.2 The main contention of Ld A.R is that the dump stock does not have market value and hence it is not valued both in the opening stock and closing stock. He submitted that the assessee is required to report the dump stock also to the Department of Mines and Geology in the Annual return and hence the assessee has reported the same. He submitted that the AO has valued the dump stock and included the same in the closing stock only. Inviting our attention to page 94 of the Annual return, wherein the quantity details are given, the Ld A.R submitted that the dump stock of 5,80,830 MT is shown as opening stock also, i.e., it is brought

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forward from earlier years. Hence, the AO should have increased the value of opening stock also, in which case, the said exercise shall be revenue neutral. He submitted that the assessee did not value dump stock quantity in the preceding years also. Accordingly he submitted that the impugned addition should be deleted.

6.3 The Ld D.R, on the contrary, submitted that it is not clear from record as to whether the opening stock includes the value of dump stock or not. He submitted that the quantity reported to the Department of Mines included dump stock of 580830 MT and hence the AO has valued the same.

6.4 We heard rival contentions on this issue and perused the record. The table containing quantity details have been extracted by us in an earlier paragraph from the Annual return filed with Department of Mines. A perusal of the same would show that the assessee is segregating its stock into two categories, viz., "From Opencast working" and "Dump working". It can also be noticed that the quantity of opening stock as well as closing stock of Dump workings was 580830 MT as on 1.4.2011 and 31.03.2011. Before us, the Ld A.R submitted that the dump stock has not been valued both for opening stock and closing stock. We find that the said submission to be true from page 32 of the paper book, wherein the quantity details is given in Point 28(a) of the Tax audit report. The opening stock quantity is shown at 193559 MT. There is no production during the year and sales during the year is 152360 MT. Accordingly the closing stock quantity is shown at 41,199 MT. The value of opening stock shown by the assessee is Rs.4,24,98,060/- for the quantity of 193559, which translates to average price of Rs.219.56 per MT. We notice that the AO has adopted the very same rate for valuing the dump stock, meaning thereby, the

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assessee has not considered dump stock for opening stock purpose also, though the same was reported to the Department of Mines. Hence it is seen that the assessee is adopting consistent practice of considering the realizable value of dump stock as Nil. In these set of facts, we are of the view that the AO was not justified in valuing the closing stock of dump stock by adopting the price applicable to good stock, when the assessee is consistently considering the realizable value of dump stock at NIL. Further, the very same stock has been brought forward from the prior year, wherein the value of dump stock was taken as NIL. Hence the AO was not justified in changing his stand and valuing the dump stock as on 31.3.2012 alone. Accordingly, we are of the view that the Ld CIT(A) was not justified in confirming this addition. Accordingly, we set aside the order passed by Ld CIT(A) and direct the AO to delete this addition made by valuing dump stock.

7. In the result, the appeal filed by the assessee for AY 2012-13 is partly allowed and the appeal filed for AY 2013-14 is allowed.

Order pronounced in the open court on 22<sup>nd</sup> Feb, 2022.

**Sd/-**  
**(N.V. Vasudevan)**  
**Vice President**

**Sd/-**  
**(B.R. Baskaran)**  
**Accountant Member**

Bangalore,  
Dated 22<sup>nd</sup> Feb, 2022.  
VG/SPS

**Copy to:**

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

By order

Asst. Registrar, ITAT, Bangalore.