IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCHES "F", MUMBAI

Before Shri G S Pannu, Accountant Member
&ShriSanjay Garg, Judicial Member

ITA No. 2329/A/2008 A.Y 2005-06
ITA No. 1142/A/2010 A.Y 2006-07

ITO Ward 4(3), Ahmedabad.	Vs.	Forever Precious Jewellery& Diamonds Ltd., Mumbai PAN AAACF4594P
(Appellant)		(Respondent)

ITA No. 3775/Mum/2011 A.Y. 2005-06
ITA No.3776/Mum/2011 A.Y. 2006-07
ITA No.3783/Mum/2011 A.Y. 2007-08
ITA No.4295/Mum/2013 A.Y 2007-08

The Dy. CIT Cent. Cir. 1, Mumbai	Vs.	Forever Precious Jewellery& Diamonds Ltd., Mumbai PAN AAACF4594P
(Appellant)		Respondent)

Appellant By : Shri G M Doss– CIT -DR
Respondent By : S/Shri F V Irani& Rajesh Shah

Date of Hearing :29.06.2016		Date of Pronouncement : 30.09.2016

O R D E R

Per Sanjay Garg (Judicial Member) :

The above captioned appeals, all by the Revenue relating to the same assessee, have been heard together and are being disposed off by this consolidated order. Before proceeding, we would like to mention that the appealsinITA Nos.2329/A/2008 &1142/A/2010 for A.Ys2005-06&2006-07

respectively have been transferred from Ahmedabad Benches to Mumbai Benches vide the order of the Hon'ble President dated 24.0.2012.

2. The appeals in ITA Nos. 2329/A/2008, 1142/A/2010 & 4295/Mum/2013 for A.Ys. 2005-06, 2006-07 & 2007-08 respectively, are in respect of assessment proceedings completed u/s. 143(3) of the Act, whereas the appeals in ITA Nos. ITA No. 3775, 3776 & 3783/Mum/2011 for A.Ys. 2005-06 2006-07&2007-08respectively are in respect of assessment proceedings carried out u/s. 143(3) r.w.s. 153C of the Act.

3. We shall first take up the appeal in ITA No. 2329/A/2008 for A.Y. 2005-06 in relation to the assessment proceedings u/s. 143(3) of the Act as a lead case. In the said appeal, the Revenue has taken the following grounds of appeal:

> *"1.The Ld. CIT(A) has erred in law and on the facts of the case in deleting the addition of Rs.1,51,33,873/- made u/s. 68 on account of share application money received from ShriAshish Jain. The Ld. CIT(A) has also erred in admitting fresh evidence in violation of Rule 46A.*
>
> *2. The Ld. CIT(A) has erred in law and on the facts of the case in deleting the disallowance of deduction u/s. 10A at Rs.74,72,739/-*
>
> *3. The LdCIT(A) has erred in law and on the facts of the case in deleting the addition of Rs.89,33,998/- on account of valuation of closing stock.*
>
> *4. The Ld. CIT(A) has erred in law and on the facts of the case in stating that the addition to closing stock has been made on the basis of market price of the raw materials after the year ending 31.3.2005.*
>
> *5. On the facts and in the circumstances of the case, the Ld. CIT(A) ought to have upheld the order of the Assessing Officer.*
>
> *6. It is, therefore, prayed that the order of the Ld. CIT(A) may be cancelled and that of the Assessing Officer may be restored to the above effect."*

Ground No.1

4. Vide ground no.1, the Revenue has agitated the action of the CIT(A) in deleting the addition of Rs.1,51,33,873/- made by the AO u/s. 68 of the I.T

Act. During the assessment proceedings, the AO noticed that the assessee company had issued shares to two Indian Companies and to a non-resident Indian settled in Hong Kong namely Mr. Ashish Jain.The AO got satisfied about the investments made by the two companies; however, in case of investments made by Mr. Ashish Jain, the AO observed that the assessee could not submit sufficient evidence regarding his creditworthiness and even about the genuineness of transactions. The AO also observed that the assessee has also not paid any dividend to its share holders including ShriAshish Jain. He also observed that the share capital from Ashish Jain had been remitted through banking channel from New York whereas the said Mr. Jain was residing at Hong Kong. He therefore made the impugned additions u/s. 68 of the Act holding that the above money was introduced by the assessee itself. Being aggrieved, the assessee preferred appeal before the CIT(A).

5. The learned CIT(A) deleted the additions so made by the AO observing as under:

> *"I have considered the submissions of the A.R. carefully and gone through the cases cited by the A.R. The A.O. has made addition of share capital received from ShriAshish Jain to the tune of Rs.1.51 crores on the ground that the appellant has not proved the creditworthiness of the share holder and genuineness of transaction. In this case the appellant has furnished a confirmation letter from ShriAshish Jain and he has stated that he is a Non Resident Indian settled in Hong Kong and the appellant has furnished copy of Certificate of foreign inward remittance issued by Standard Chartered Bank in support of receipt of money from ShriAshish Jain. However, the A.O. made addition on the ground that ShriAshish Jain did not furnish any details about his tax assessment particulars. I find from the details furnished by the A.R. that identity of the shareholder is proved and also receipt of money from ShriAshish Jain through banking channel is proved. The appellant has furnished a certificate regarding remittance from Standard Chartered Bank, New York, copy of share certificate of ShriAshish Jain was also furnished. The A.R. has cited several decisions to claim that only identity of the share applicant was required to be proved. To meet the objections raised by the A.O. the appellant has also filed a statement of net worth of ShriAshish Jain duly certified by the auditors Peter Y. H. Lam & Co., Certified Public Accountants, Hong Kong which clarifies that ShriAshish Jain is carrying on business activity in the name of M/s. Alma Diamonds Co. Limited of*

> *which he is the Managing Director and that his company is enjoying credit limit of US $ 1 Million and it also confirms that he has remitted US Dollars of 329,935 for share capital in the appellant company. It also confirmed that ShriAshish Jain as a tax payer in Hong Kong. In view of the above details furnished it is held that creditworthiness of the share holder is proved. Hence on consideration of acts and details filed and case laws relied upon by the A.R., I hold that the addition of unexplained share capital cannot be sustained and the same is therefore, deleted."*

Being aggrieved by the above order of the CIT(A), the Revenue has come in appeal before us.

6. We have heard the rival contentions and have also gone through the record. We find that the learned CIT(A) has given a well-reasoned finding. The assessee has not only furnished confirmation letter from Mr. Ashish Jain but also the evidence in the shape of certificate of foreign inward remittance issued by Standard Chartered Bank in this respect. The learned CIT(A) has categorically held that not only the identity of the share holder but also the receipt of money by the assessee from Mr. Ashish Jain through banking channel has been proved. Moreover, the learned CIT(A) has also observed that the assessee has also filed a statement of net worth of Mr. Ashish Jain duly certified by his auditors. We do not find any infirmity in the above well-reasoned order of the CIT(A) on this issue. This ground of appeal of the Revenue is therefore, dismissed.

Ground No.2

7. With respect to ground no.2, the learned AR of the assessee has fairly stated that the claim regarding deduction u/s. 10A in respect to the Surat unit regarding which the impugned disallowance has been made by the AO has been withdrawn by the assessee and the corresponding income has been offered for taxation in the return of income filed u/s. 153C pursuant to the search action carried out in the case of Group Company. Since the assessee itself has offered the income in the subsequent return filed u/s. 153C of the Act, this ground of appeal becomes infructuous and does not need any adjudication.

Ground No.3

8. Vide ground nos. 3 & 4 the Revenue has agitated the action of the CIT(A) in deleting the addition of Rs. 89,33,998/- on account of valuation of closing stock. This issue has been dealt by the learned CIT(A) in para 4 of his order. The AO observed that the assessee was not maintaining its stock register and has valued the closing stock on the basis of weighted average method. In absence of maintenance of stock item-wise, the A.O. held that the inventory was to be valued as per FIFO method. Further, that the assessee had sold the articles at a higher price as compared to the purchase cost as on 31.3.2005. The A.O worked out the value of closing stock of raw materials and worked out the difference in valuation of Rs.89,33,998/- after taking into account FIFO method and added the same to the income of the assessee.

9. In appeal, the learned CIT(A) deleted the additions so made by the AO by observing as under:

> *"I have considered the submissions of the A.R. carefully. The A.R. has made a detailed submissions saying that the appellant has adopted market rate of valuation of raw materials like gold and diamond as the market rate was lower as on 31.3.2005. The A.O. has taken into consideration the selling price of raw materials for the period after 31.3.2005 and nto the selling rate as on 31.3.2005. Further, the A.O. has not brought on record any material nor has given any reasons to reject the certificate filed by the appellant from the Bank of Scotia Mocatta giving the rate of gold as on 31.3.2005 as USD 427.50 per OZ for 0.995 purity as evidence for the cost price of gold as on 31.3.2005. Further, the A.O. has increased value of loose diamonds in store and on production as WIP, but has ignored the value of diamonds which have got studded in jewellery and he has not taken into account the compensatory effect for increase in valuation of diamonds for the diamonds used in studded jewellery as that would reduce the addition to lower figure than what has been calculated by the A.O. This has been explained by the A.R. in para 4.13 of his submission stated hereinabove. Further, whatever addition is made to the valuation of closing stock in the year under consideration, the same has to be given set off in the subsequent year as opening stock and there will no net tax effect. In view of the above facts, the addition to closing stock valuation made by the A.O. on the basis of market price of the raw materials after the year ending on 31.03.2005 can not be sustained and the addition is therefore deleted."*

Being aggrieved by the above order of the CIT(A), the Revenue has come in appeal before us.

10. We have heard the rival contentions and have also gone through the record. We find that the method for valuation of stock adopted by the assessee is one of the recognized methods as per the Accounting Standards. The said method has been consistently followed by the assessee. It has also been explained that the inventory was being valued at lower of cost or market value as per the accounting principles. It has also been explained that the gold jewellery is being sold or exported in domestic and overseas market on the basis of the prevailing market rates at the time of the transaction. The learned AR of the assessee has further submitted that the stock register was also being maintained and the tax audit report has also been submitted. Further any addition in the value of closing stock at the end of the year will increase the corresponding opening stock at the beginning of the next financial year. The learned CIT(A) therefore has rightly held that the addition to the closing stock made by the AO on the basis of market price of the raw material after the year ending on 31.03.2005 was not sustainable in the eyes of law. We do not find any infirmity in the order of the CIT(A) in this respect. The order of the CIT(A) on this ground is therefore, upheld.

11. Ground nos. 5 & 6 are general in nature and do not require any adjudication.

12. In view of our findings given above, the appeal of the Revenue is dismissed.

ITA No. 1142/A/2010 for A.Y 2006-07

In this appeal, the Revenue has raised the following grounds of appeal:

> *"1. The Ld. CIT(A) erred in law and on facts allowing the claim of deduction u/s. 10AA of the Act.*

1.1 The Ld. CIT(A) has erred in law and on facts in not appreciating the fact that the assessee is not the owner of the unit but has got it sub-contracted through unit in a SEZ Zone.

1.2 The Ld. CIT(A) erred in law and on facts in not appreciating the fact that the assessee who is claiming deduction u/s. 10AA of the Act should manufacture the goods itself by employing its machinery or equipments.

1.3 In doing so, the Ld. CIT(A) has erred in law and facts in not appreciating that the assessee was not an entrepreneur as defined in section 2 of the SEZ Act 2005 and was not even granted a letter of approval by the concerned Development Commissioner.

2. The Ld. CIT(A) erred in law and on facts in deleting the disallowance of Rs.62,35,814/- made on account of incorrect valuation of closing stock.

2.1 In doing so, the Ld. CIT(A) erred in law and on facts in observing that the assessee Company is showing profits in the subsequent years without appreciating that the assessee cannot be given benefit of wrong valuation of inventory.

3. On the facts and in the circumstances of the case, the Ld. CIT(A) ought to have upheld the order of the Assessing Officer.

4. On the facts it is therefore prayed that the order of the Ld. CIT(A) may be set aside and that of the A.O. may be restored to the above extent."

13. A perusal of the above grounds of appeal, it reveals that there are two effective issues raised by the Revenue. The issue raised in grounds nos. 1 to 1.3 relates to the claim of deduction u/s. 10AA of the Act, whereas the issue raised vide ground nos. 2 and 2.1 relates to disallowance made on account of valuation of closing stock. Ground nos. 3 & 4 are general in nature.

Grounds No. 1 to 1.3

14. The grievance of the Revenue raised vide ground no.1 to 1.3 is in relation to the action of the CIT(A) in allowing the claim of deduction to the assessee u/s. 10AA of the Act in respect of its Chennai unit. The brief facts of the case are that the assessee had been running a unit in the SEZ in Chennai during the relevant period and it earned foreign exchange through export of

manufacturing goods. The AO, however, rejected the assessee's claim for deduction u/s. 10AA of the I.T.Act on the following ground:

> "(i) The appellant had not manufactured the goods (in terms of the provisions of sec. 10AA) therefore it was not entitled for deduction under the section;
>
> (ii) The A.O. has further observed that the convertible foreign exchange was not brought into India within the time of six months as envisaged in the section;
>
> (iii) The appellant filed Form No. 56F required for claiming the deduction u/s. 10AA only during the assessment proceedings."

The learned CIT(A) however allowed the claim of the assessee observing as under:

> *"6.10 As held by my Ld. Predecessor in the appellate order for the A.Y. 2005-06 there is no stipulation in section 10A or 10AA that the assessee who is claiming deduction under these sections should manufacture the goods itself by employing its machinery or equipment. It may further be pointed out that the scope of section 10AA is wider than section 10A. Sub section (1) of section 10AA provides that subject to the provisions of this section, in computing the total income of an assessee, being an entrepreneur as referred to in clause (j) of section 2 of the Special Economic Zones Act, 2005, from his unit who begins to manufacture or produce articles or things or provide any services during the previous year relevant to any assessment year commencing on or after the 1st day of April 2006 shall be allowed specified deduction. It is clear from the language of the section that the deduction is available in respect of manufacture or production of articles or things or providing any services. Further, for the purposes of section manufacture have been assigned the same meaning as laid down in clause (r) of section 2 of Special Economic Zones Act, 2005.*
>
> *6.11 As per the provisions of section 2® of SEZ Act 2005 "manufacture" means to make, produce, fabricate, assemble, process or bring into existence, by hand or by machine, a new product having a distinctive name, character or use and shall include processes such as refrigeration, cutting, polishing, blending, repair, remaking, reengineering and includes agriculture, aquaculture, animal husbandry, floriculture, horticulture, pisciculture, poultry, sericulture, viticulture and mining. This itself shows that the word manufacture used in section 10AA takes various activities in its compass. Further, even for the sake of argument if we hold that the appellant was not*

engaged in manufacturing activity yet it cannot be denied deduction u/s. 10AA simply because the persons who are providing any kind of services are also entitled for deduction under the section. The word 'services' has not been defined in the section as well as in the SEZ Act 2005 therefore, it has to be understood in its general connotation.

6.12 As regards Assessing Officer's finding that the appellant did ot bring into India the convertible foreign exchange within six months of Export. I may be seen that the units situated in SEZs were permitted to realize and repatriate to India the full export value within the period of 12 months from the date of export. In terms of Circular No.91 dated 1.4.2003 issued by RBI in connection with "Export of Goods and Services –Facilities of Units in Special Economic Zones (SEZ)", the units situated in SEZ have been permitted to realize and repatriate to India the full value of goods or software within a period of 12 months or beyond. Since the appellant has brought the convertible foreign exchange within 12 months of the Export t is within time so far as RBI guidelines is concerned.

6.13 In so far as the Assessing Officer's objection with regard to filing of form No. 56F for claiming the deduction u/s. 10AA beyond the prescribed time is concerned it may be seen that it is a well settled law that the filing of Audit report for claiming deduction in a specified Form is a procedural requirement. Therefore non filing of requisite Form along with the return of income does not impair the appellant's claim for deduction unless there are other material reasons on which such claim could be rejected. In this regard reliance is placed on the decision of Hon'ble Calcutta High Court in the case of CIT vs Berger Paints (India) Ltd. 254 ITR 503 Abd the decisions of Hon'ble Kerala High Court in the case of CIT vs. G.Krishnan Nair 259 ITR 727

6.14 Therefore, keeping in view the legal position as stated above I don't find any reason to deviate from the findings of my ld. Predecessor in this regard. In the given circumstances, there is no ground under which the deduction claimed by the appellant u/s. 10AA can be refused. In view of this, the A.O. is directed to allow the appellant the deduction under section 10AA of the Act accordingly."

15. Being aggrieved by the above order of the CIT(A) the Revenue has come in appeal before us.

16. The learned DR has vehemently contented before us that no manufacturing activity has been carried out by the assessee at its SEZ units. The

entire work was outsourced to the third party and, therefore, the assessee was not entitled to claim deduction u/s. 10AA of the Act.

The learned AR, on the other hand, while relying on the decision of the Hon'ble Bombay High Court in the case of Neo Pharma Private Ltd. [1982] 137 ITR 879 has contended that under an agreement the assessee had got the articles manufactured in another company under its direct supervision and quality control and the raw material was also supplied by the assessee. Under such circumstances the risk was of the assessee for the entire operation undertaken and the products manufactured at the assessee's cost were the property of the assessee. That, under such circumstances, itis to be deemed that the resultant products were manufactured by the assessee and, therefore, the assessee has rightly claimed deduction u/s. 10AA. The learned AR has further relied upon the findings of the learned CIT(A) as reproduced above. He has further contended that even under the provisions of section 10AA the word "services" has also been used. He has therefore contended that it is not only the production or the manufacturing activity in respect of which the deduction u/s. 10AA of the Act can be claimed but also for the services also. He, therefore, has contended if the assessee has obtained the services of a third party who is situated in the same SEZ, then in the light of the decision of the Hon'ble Bombay High Court in the case of Neo Pharma Private Ltd.(supra) it will be deemed that the goods have been manufactured by the assessee itself.

17. We have considered the rival contentions and have gone through the impugned order of the CIT(A). Before further deliberating upon the matter, we find it fit it to reproduce the relevant part of the provisions of section 10AA of the Act: -

> **"10AA.** (1) Subject to the provisions of this section, in computing the total income of an assessee, being an entrepreneur as referred to in clause (*j*) of section 2 of the Special Economic Zones Act, 2005, from his Unit, who begins to manufacture or produce articles or things or provide any services during the previous year relevant to any assessment year commencing on or after the 1st day of [93]**[***April, 2006, a deduction of***]**—

(*i*) hundred per cent of profits and gains derived from the export, of such articles or things or from services for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which the Unit begins to manufacture or produce such articles or things or provide services, as the case may be, and fifty per cent of such profits and gains for further five assessment years and thereafter;

(*ii*) for the next five consecutive assessment years, so much of the amount not exceeding fifty per cent of the profit as is debited to the profit and loss account of the previous year in respect of which the deduction is to be allowed and credited to a reserve account (to be called the "Special Economic Zone Re-investment Reserve Account") to be created and utilized for the purposes of the business of the assessee in the manner laid down in sub-section (2).”……..

A perusal of the above provision reveals that to be eligible to claim deduction u/s. 10AA, the assessee should be an entrepreneur as referred to in clause (j) of section 2 of SEZ Act 2005. Further the income of the assessee referred to is not of the unit but the relevant words are **“from his unit”.**Thirdly, the assessee must begin **to manufacture**or to **produce** articles or things or **provide** any **services** during the relevant previous year. A perusal of the above reproduced provisions and further from the reading of the entire provisions of section 10AA, it reveals that the location of the unit is very important. To claim deduction u/s. 10AA, the unit must be established in SEZ. These SEZs are established by the Central Government or the State Government or by the third parties with the permission or sanction of the Government for the purpose of development of the area and for encouraging exports. Even the preamble of the “The Special Economic Zones Act, 2005” reads as under:

“An Act to provide for the establishment, development and management of the SpecialEconomic Zones for the promotion of exports and for matters connected therewith orincidental thereto.”

The definition of “entrepreneur” as referred to in clause (j) of section 2 of SEZ Act 2005 reads as under:

“(j) “entrepreneur” means a person who has been granted a letter of approval by the Development Commissioner under sub-section (9) of section 15”.

Now sub-section (9) of section 15 is read as under:

“(9) The Development Commissioner may, after approval of the proposal referred to in sub-section (3), grant a letter of approval to the person concerned to set up a Unit and undertake

such operations which the Development Commissioner may authorise and every such operation so authorised shall be mentioned in the letter of approval."

Further Rule 19 of the 'SEZ Rules 2006' read as under:

> "19. Letter of Approval to a Unit.— (1) On approval of a proposal under rules 18 and 19, Development Commissioner shall issue a Letter of Approval in Form G, for setting up of the Unit. (2) The Letter of Approval shall specify the items of manufacture or particulars of service activity, including trading or warehousing, projected annual export and Net Foreign Exchange Earning for the first five years of operations, limitations, if any on Domestic Tariff Area sale of finished goods, by-products and rejects and other terms and conditions, if any, stipulated by the Board or Approval Committee:"

The learned AR of the assessee in this respect has relied upon the letter of approval dated 21.09.2005 issued by the Development Commissioner, which reads as under:

> "Sir,
>
> Sub : Your application for permission under the Special Economic Zone Scheme for setting up a manufacturing & trading unit in MEPZ – SEZ – reg.
> Ref: Your application dated 17/8/2005
>
> With reference to the above-mentioned application, Government/Development Commissioner is pleased to extend to you all the facilities and privileges admissible and subject to the provisions as envisaged in Special Economic Zone Scheme 2004-2009 for the establishment of a new undertaking at MEPZ – Special Economic Zone for the manufacture & trading of the following items up to the capacities specified below on the basis of maximum utilization of plant and machinery.
>
> | Item(s) of manufacture/trading | Unit | Annual capacity |
> |---|---|---|
> | Plain Gold Jewellery (for manufacture) | KG | 500 |
> | Cut & Polished Diamonds (for trading) | Carats | 6000 |
>
> The above permission is subject to the conditions stipulated in Annexure in addition to the following conditions:
>
> …..
>
> x) You shall be required to enter into a Legal Agreement in the prescribed form (Appendix 14-1 F) with the Development Commissioner, MEPZ- SEZ for fulfilling the terms and conditions mentioned in the LOP

xi) You are requested to confirm acceptance of the above terms and conditions to the Development Commissioner, MEPZ –SEZ within 45 days.

xii) If you fail to comply with the condition stipulated above, this letter of approval is liable for cancellation/revocation.

xiii) In the case of any adverse remarks noticed against the Directors of your company, the LOP will be cancelled.

xiv) All future correspondence for amendments/changes in terms and conditions of the approval letter or for extension of its validity, if required etc., may be addressed to the Development Commissioner, MEPZ – SEZ.

This issues with the approval of Development Commissioner, MEPZ – SEZ

Yours faithfully,

SD/-
(C.R.KALAVATHY)
ASST. DEVELOPMENT COMMISSIONER
FOR DEVELOPMENT COMMISSIONER"

The above reproduced approval letter read with section 15(9) of the SEZ Act 2005 and Rule 19 of the SEZ Rules 2006 reveals that the facilities and privileges as admissible to the units situated in SEZ have been granted to the assessee for the manufacture of plain gold jewelleryupto 500 kg on the basis of maximum utilization of plant and machinery. The assessee has also been granted facilities and privileges as admissible for trading activity in gold and polished diamonds as noted above. It is pertinent to note here that the Development Commissioner has to particularly specify as to what activities or authorized operation are allowed to be carried out in an SEZ unit for the claim of privileges and benefits under SEZ Act.

Now the question comes whether the above provisions of the SEZ Act and SEZ Rules can be invoked to decide the benefits admissible to an assessee under the Income Tax Act. Section 57 of the SEZ Act is relevant in this respect which read as under:

> "57. With effect from such date as the Central Government may by notification appoint, the enactments specified in the Third Schedule shall be amended in the manner specified therein: Provided that different dates may be appointed on which the amendments specified in the Third Schedule shall apply to a particular Special Economic Zone or a class of Special Economic Zones or all Special Economic Zones."

After going through the relevant provisions of the above statutes, we find that the SEZ Act is the main Act under provides to give certain incentives to the SEZ units. To give effect to the provisions of the SEZ Act, corresponding amendments have been made in the relevant provisions of various related Acts as mentioned in the Third Schedule to the Act, relaxing the conditions or providing for incentives or deductions to the SEZ units. It is to be mentioned here that Income Tax Act 1961 inter alia is also included in the Third Schedule and it has also been provided as to what amendments are made into the provisions of the Income Tax Act to give effect to the provisions of the SEZ Act 2005. Further sections 27 and 57 of the SEZ Act are also relevant in this respect which read as under:

> "**27.** The provisions of the Income-tax Act, 1961, as in force for the time being, shall apply to, or in relation to, the Developer or entrepreneur for carrying on the authorised operations in a Special Economic Zone or Unit subject to the modifications specified in the Second Schedule."

> "**51**. (1) The provisions of this Act shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force or in any instrument having effect by virtue of any law other than this Act."

So a perusal of the relevant provisions reveal beyond doubt that to get the income tax benefits under the Act there must be some manufacture or production of a thing or providing of services by a unit situated in SEZ and having approval of the competent authority in this respect. The manufacturing activity or services activity should be provided by the unit situated in the SEZ. The location of the unit in the SEZ and the required approvals of the competent authority to carry out the operations are very much necessary. Hence as per the provisions of section 10AA of the Income Tax Act 1961, the assessee is entitled to deduction on the manufacturing activity only as approved in the above reproduced approval letter of the Development Commissioner of the SEZ. The assessee's unit has not been approved for providing of any services.

Even, we find that in the case in hand the assessee has allegedly imported raw material/gold and exported the jewellery. It is not the case that the assessee has offered /provided any services to itsoff shore customers. The assessee, in fact, had obtained services of third party for getting the jewellery manufactured. The incentives under the provisions of the Act are available on the offer or for providing of services and not for taking the services from a third party. Event it is not that each or any service can be provided by a unit in SEZ to get benefits. What services can be carried out to avail the benefits by the units situated in the SEZ has also been mentioned under the provisions of 'SEZ Rules 2006'. The relevant Rule is reproduced as under: :

> **"76**. The "services" for the purposes of [1][clause] (z) of section 2 shall be the following, namely:—
> Trading, warehousing, research and development services, computer software services, including information enabled services such as back-office operations, call centres, content development or animation, data processing, engineering and design, graphic information system services, human resources services, insurance claim processing, legal data bases, medical transcription, payroll, remote maintenance, revenue accounting, support centres and web-site services, off-shore banking services, professional services (excluding legal services and accounting) rental/leasing services without operators, other business services, courier services, audio-visual services, construction and related services, distribution services (excluding retail services), educational services, environmental services, financial services, hospital services, other human health services, tourism and travel related services, recreational, cultural and sporting services, entertainment services, transport services, services auxiliary to all modes of transport, pipelines transport."
> Explanation: The expression "trading", for the purposes of the Second Schedule of the Act, shall mean import for the purposes of re- export."

18. As discussed above, even the assessee has not been authorized to provide any services from its SEZ unit. Hence the contention of the Ld. AR that the assessee is entitled to deduction U/s 10AA because it is providing services is not tenable.

19. Now the question before us comes whether the production or the manufacturing activity is to be carried out in the unit itself or it can be outsourced to some other party. We find that there are provisions in this respect under the SEZ Rules 2005. The relevant part of the said Rules is reproduced as under:

"**41. Sub-contracting** —

(1) A Unit may sub-contract a part of its production or any production process, to a unit(s) in the Domestic Tariff Area or in a Special Economic Zone or Export Oriented Unit or a unit in Electronic Hardware Technology Park unit or Software Technology Park unit or Bio-technology Park unit with prior permission of the Specified Officer to be given on an annual basis and subject to following conditions, namely:—

(a) the finished goods requiring further processing or semi-finished goods including studded jewellery, taken outside the Special Economic Zone for sub-contracting shall be brought back into Unit within one hundred and twenty days or within such period as may be extended by the Specified Officer for reasons to be recorded in writing for grant of such extension;

(b) cut and polished diamonds and precious and semi-precious stones (except rough diamonds, precious or semi-precious stones having zero duty) shall not be allowed to be taken outside the Special Economic Zone for sub-contracting;

(c) a gem and jewellery Unit may receive plain gold or silver or platinum jewellery from the Domestic Tariff Area or from an Export Oriented Unit or from a Unit in the same or another Special Economic Zone in exchange of equivalent content of gold or silver or platinum contained in the said jewellery after adjusting permissible wastage or manufacturing loss allowed under the provisions of the Foreign Trade Policy read with the Handbook of Procedures;

(d) in sub-contracting or exchange, wastage shall be permitted as per the wastage norms admissible under the Foreign Trade Policy read with the Handbook of Procedures:

Provided that the total wastage of the Unit, including the wastage of the sub-contractor or the supplier of jewellery on exchange basis, shall not in any case exceed the wastage permissible under the Foreign Trade Policy read with the Handbook of Procedures;

(e) the Domestic Tariff Area Unit undertaking sub-contracting or supplying jewellery against exchange of gold or silver or platinum shall not be entitled to export entitlements;

(f) the value of the sub-contracted production of a Unit in any financial year shall not exceed the value of goods produced by the Unit within its own premises in the immediately preceding financial year:

Provided that a Unit, sub-contracting part of the production or production process to other Unit in the same Special Economic Zone shall not require the permission of the Specified Officer provided that both the supplying and receiving Units shall maintain proper account of the goods involved in the subcontracting.

Explanation : For removal of doubts it is clarified that the expression "sub-contracting" of a part of its production under this rule shall mean sub-contracting all the production processes for conversion of raw material into finished products but only for a part of the quantity of the finished products exported during the year or in the first year of production, the value of the goods sub-contracted shall not exceed the value of goods produced by the unit in its own premises during the first year of production;

(g) a Unit engaged in trading or warehousing shall not be allowed the facility of sub-contracting of production or production process in the domestic tariff area;
(h) a Unit may remove, with the permission of Specified Officer, moulds or jigs or tools or fixtures or tackles or instruments or hangers and patterns and drawings to the premises of subcontractor(s), subject to the condition that these shall be brought back to the premises of the Unit immediately on expiry of such sub-contracting arrangement and submission of a quarterly verification report from the Central Excise Officer having jurisdiction over the sub-contractor that such goods are lying in the sub-contractor's premises and are being used for production of goods on account of the Unit;
(i) raw materials, components and consumables excluding fuel may be sent along with these goods, or separately.

(2) The Development Commissioner may also permit sub-contracting of part of the production process abroad and in such cases, the goods may be exported from the sub-contractor's premises abroad subject to following conditions, namely:—
(a) sub-contracting charges shall be declared in the export declaration forms and invoices and other related documents;
(b) the export proceeds shall be fully repatriated in favour of the Unit.

(3) A Developer or a co-developer or on their behalf their contractor, as the case may be, may also temporarily remove the goods, procured or imported duty free by them for their authorized operations, to a place in the Domestic Tariff Area or a unit in the same or another Special Economic Zone or Export Oriented Unit or a unit in Electronic Hardware Technology Park Unit or Software Technology Park Unit or Bio-technology Park Unit, for sub-contracting a process, with prior permission of and subject to such conditions as may be prescribed by the Approval Committee.]

42. Procedure for sub-contracting in Domestic Tariff Area or in a Unit in other Special Economic Zones or in Export Oriented Unit or in Electronic Hardware Technology Park Unit or in Software Technology Park Unit or Bio-technology Park Unit or sub-contracting abroad
(1) A Unit may take goods, including finished goods requiring further processing or semi-finished or semi-processed goods, including studded jewellery or inputs to the sub-contractor's premises—
(i) for sub-contracting any production process; or
(ii) part of the production, without payment of duty, subject to following conditions, namely:—
(a) the Unit shall wherever possible apply for the permission at the time of project approval itself and based on such initial approval, the Specified Officer shall permit subcontracting of part of production process(es) or part of the production;
(b) where the permission has not been taken at the time of project approval or a new permission is sought, the unit shall file an application containing the name

and address of the subcontractor(s), Central Excise registration number in the case of the Domestic Tariff Area sub-contractor, if registered, and details of the processes to be carried out or quantum of production sought to be carried out at the sub-contractor's premises and self certified input-output ratio for the said processes;

(c) after examination of details under sub-clause (b), the Specified Officer may grant annual permission for sub-contracting any production process or sub-contracting part of the production, as the case may be;

(d) the Unit, removing raw materials, consumables excluding fuel and components, imported or domestically procured without any processing, for sub-contracting into the Domestic Tariff Area, shall furnish bank guarantee to Specified Officer to cover the duty foregone on such materials being taken out for subcontracting: Provided that bank guarantee shall not be required by a unit whose turnover is rupees one crore or above or where the unit is in the Special Economic Zone for more than a period of two years with an unblemished track record;

(e) the Specified Officer or the Authorized Officer may make random checks either at the job worker's premises or after receipt of goods from the job worker at the Special Economic Zone gate for the purpose of verification of goods which were sent and received: Provided that where the precious metal in bullion form, having marking of fineness or purity or make or serial number is taken out of the Special Economic Zone for sub-contracting, appraisement of precious metals shall not be mandatory;

(f) a Unit shall remove the goods under serial numbered challans pre-authenticated by the owner or Managing Director or working partner or the company secretary or by any person duly authorized in this behalf by the company or firm, as the case may be, and complete description of goods shall be provided on the challan;

(g) the authorized officer at the Special Economic Zone gate shall note down the identification marks of the goods for verification of the goods when received back after sub-contracting:

Provided that where sensitive items are sent out for subcontracting, based on the risk profile or past performance of the unit, sample may be drawn and retained by the Specified Officer, if required:

Provided further that for gem and jewellery Units, there shall be no requirement for drawal of samples;

(h) the goods sent out for sub-contracting shall be returned to the Unit within one hundred and twenty days from the date of removal or within such period as may be extended by the Specified Officer for reasons to be recorded in writing for granting such extension;

(i) in case of failure by the Unit to bring back the goods after sub-contracting within the period under sub-clause (h), action shall be taken by the Specified Officer to recover the duty on the goods taken out for sub-contracting.

(2) The Specified Officer may permit the Unit to export the finished goods directly from the sub-contractor's premises subject to following conditions, namely:—

(i) the sub-contractor is an Export Oriented Unit or an Electronic Hardware Technology Park Unit or Bio-technology Park Unit or a Special Economic Zone Unit or a Domestic Tariff Area Unit which is registered with the Central Excise Department;

(ii) export of finished goods from the sub-contractor's premises shall be allowed only by way of direct export and not through third party;

(iii) sample of goods exported from the sub-contractor's premises shall be sent by the sub-contractor in sealed condition, to the Specified Officer for establishing identity of the goods exported with the sample drawn at the time of taking out of the goods to the sub-contractor;

(iv) Shipping Bill for duty free goods shall be processed at the port of export as in the case of normal export and shipping bill shall be filed in the name of the Unit and sub-contractor;

(v) goods for such export shall be removed from the sub-contractor's premises under bond:

Provided that in case of sub-contracting abroad, the goods shall either be returned to the Unit or may be sold to buyers in that country or any third country.

(3) Waste, scrap or remnants generated during process at the subcontractor's premises may either be returned to the Unit or may be cleared on payment of duty as if the said waste or scrap or remnants have been cleared by the Unit or may be destroyed at the sub-contactor's premises in the presence of jurisdictional Central Excise Officer if the sub-contractor is a Central Excise registrant:

Provided that in case of clearance of waste or scrap at subcontractor's premises on payment of duty or destruction thereof the same shall be in accordance with the Standard Input Output Norms notified for the Duty Exemption Entitlement Scheme under the Foreign Trade Policy or as fixed by Approval Committee:

Provided further that where the sub-contractor's premises are located abroad, the scrap, waste or remnants generated at the sub-contractor's premises may either be returned to the Unit or may be disposed off abroad.

(4) A Unit may sub-contract a part of production or production process in another Unit within the same Special Economic Zone subject to the following conditions, namely:—

(i) the movement of goods shall be under serially numbered challans and record of such movement of goods shall be maintained by the Unit;

(ii) raw material imported or procured by the Unit for manufacture of capital goods may be transferred to another unit for the purpose of manufacture or fabrication of capital goods for use by the Unit which had imported or procured the raw materials.

(5) The Developer or a co-developer or on their behalf their contractor, as the case may be, shall follow the same procedure for subcontracting in Domestic Tariff area or in a Unit in other Special Economic Zones or in an Export Oriented Unit or in an Electronic Hardware Technology Park Unit or a Software Technology Park Unit as prescribed for sub-contracting by SEZ Units in sub-rule (1) above :
Provided that the Bank Guarantee to cover the duty foregone on the materials being sent for sub-contracting shall apply only in case of temporary removal of goods by the contractor.]

43. Sub-contracting for Domestic Tariff Area unit for export— A Unit may, on the basis of annual permission from the Specified Officer, undertake sub-contracting for export on behalf of a Domestic Tariff Area exporter, subject to following conditions, namely:—

(a) all the raw materials including semi-finished goods and consumables including fuel shall be supplied by Domestic Tariff Area exporter;

(b) finished goods shall be exported directly by the Unit on behalf of the Domestic Tariff Area exporter:
Provided that in case of sub-contracting on behalf of an Export Oriented Unit or an Electronic Hardware Technology Park unit or a Software Technology Park unit or Bio-technology Park unit, the finished goods may be exported either from the Unit or from the Export Oriented Unit or Electronic Hardware Technology Pak unit or Software Technology Park unit or Biotechnology Park unit;

(c) export document shall be jointly in the name of Domestic Tariff Area exporter and the Unit;

(d) the Domestic Tariff Area exporter shall be eligible for refund of duty paid on the inputs by way of brand rate of duty drawback."

20. We find that the claim of the assessee is required to be examined in the light of the provisions of SEZ Act/ SEZ Rules and also the provisions as envisaged in SEZ scheme 2007 to 2009 as referred to in the approval letter of the Development Commissioner dated 21.09.2005.

A perusal of the order of the AO and the impugned order of the CIT(A) reveals that the lower authorities have not examined the issue in the light of the provisions of SEZ Act/ SEZ Rules and other related provisions. The impugned order of the CIT(A) is therefore set aside and the matter is restored on this issue to the file of the AO for decision afresh after giving reasonable of being heard to the assessee in the light of the above stated SEZ Act/Rules and case laws as may be available or relied upon.

Ground No.2

21. Ground no.2 pertains to the addition on account of valuation of closing stock. This issue is identical to the one we have discussed while deciding the appeal for A.Y. 2005-06 above. For the reasons stated therein, the order of the CIT(A) on this ground is upheld and the ground is rejected.

22. In the result, this appeal is partly allowed.

ITA No.4295 for A.Y. 2007-08

23. The only issue raised in this appeal is identical to the issue as discussed above vide ground No.1 in Revenue's appeal for A.Y. 2006-07. In view of our finding given above this appeal is restored to the file of the AO in the terms of our directions given above.

ITA No.3775/M/2011 for A.Y. 2005-06
ITA No.3776/M/2011 for A.Y. 2006-07
ITA No.3783/M/2011 for A.Y. 2007-08

24. These appeals are in relation to the assessment proceedings carried out under section 143(3) read with section 153C of the Act. No new additions have been made pursuant to the search action. The AO has retained the same additions as were made during the original assessment proceedings under section 143(3) of the Act.

25. In view of our observations made above, the appeal bearing ITA No.3775/M/2011 is treated as dismissed as per our decision given for the relevant assessment year 2005-06 in relation to the original proceedings under section 143(3) of the Act whereas ITA No.3776 & 3783/Mum/2011 for A.Y.2006-07 & 2007-08respectively are treated as partly allowed in terms of our order in relation to the appeal nos. 1142/A/2010 & 4295/Mum/2013 for 2006-07 & 2007-

08 respectively filed in respect of original assessment proceedings carried out u/s 143(3) of the Act.

Order pronounced in the open court on 30.09.2016.

Sd/-	**Sd/-**
(G S Pannu)	**(Sanjay Garg)**
ACCOUNTANT MEMBER	JUDICIAL MEMBER

MUMBAI, Dt : 30.09.2016

Copy forwarded to :

1. The Appellant
2. The Respondent
3. The C.I.T. concerned Mumbai
4. The CIT (A) concerned Mumbai
5. The DR, "F" - Bench, ITAT, Mumbai

//True Copy// BY ORDER

ASSISTANT REGISTRAR
ITAT, Mumbai Benches, Mumbai