# IN THE INCOME TAX APPELLATE TRIBUNAL
# MUMBAI BENCH "J", MUMBAI

**BEFORE AMIT SHUKLA (JUDICIAL MEMBER)**
**AND**
**MS. PADMAVATHY S. (ACCOUNTANT MEMBER)**

**I.T.A. No.5653/Mum/2009**
**(Assessment year 2004-05)**

| DCIT-2(3), Mumbai<br>Room No.555, Aayakar Bhavan<br>M.K. Road, Mumbai-400 020 | vs | M/s Zensar Technologies Ltd<br>Magnet House, 2nd Floor<br>N.M. Marg, Ballard Estate<br>Mumbai-400 001<br>**PAN : AAACF0742K** |
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| **APPELLANT** | | **RESPONDENT** |

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| Assessee represented by | Shri Nitesh Joshi |
| Department represented by | Shri Manoj Kumar – CIT DR |

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| Date of hearing | 12-04-2023 |
| Date of pronouncement | 19-04-2023 |

## O R D E R

**PER : MS PADMAVATHY S. (AM)**

This appeal of the Revenue is against order of the Commissioner of Income-tax (Appeals)-XXXII, Mumbai [hereinafter 'Ld.CIT(A)] dated 23/07/2009 for the assessment year 2004-05.

2. The Revenue raised the following grounds of appeal:-

> "On the facts and in the circumstances of the case and in law. the learned C1T(A) has erred in allowing relief to the assessee to the extent impugned in the grounds enumerated below:

1. The Ld.CIT(A) erred in deleting the disallowance of Rs.43.90.000/- by way of non-compete fees and holding that the expenditure incurred for non-compete fees should be allowed as revenue expenditure in full in the relevant assessment year without appreciating the fact that the assessee derived continued benefit over the agreement period in respect of the non-compete fees and hence, the relevant expenditure by way of non-compete fees should have been spread over the period of the benefit in view of the decision of the Hon'ble Supreme Court in the case of Madras Industrial Investment Corporation Ltd. vs. C1T [225 ITR 802 (SC)].

2. The CIT(A) erred in deleting the disallowance of Rs.22,08,494/- being the employees' stock option expenses claimed by the assessee without appreciating the fact that no such option was exercised by the assessee during the relevant previous year.

3.

(a)The C1T(A) erred in directing the A.O. to grant the assessee deduction u/s.SOHHE in respect of "profit of the business" without setting off of the brought forward business loss relying on the decisions of the Mumbai I'l'A'L in case of Unichem Laboratories Limited and Cabot India Limited, which, in turn, were based on the decision of the Hon'ble Bombay High Court in the case of Shirke Construction Equipment Limited, without appreciating the fact that the decision of the Hon'ble Bombay High Court in the case of Shirke Construction Equipment Limited has been overruled by the Hon'ble Supreme Court in the case of M/s. IPCA Laboratories Limited vs. DC IT in 266 ITR 521 (SC).

(b)The CIT(A) ought to have held that the Section 80-AB had an overriding effect over all other sections in the Chapter Vl-A and hence, no deduction U/S.80-HHE was available to the assessee on account of there being no business income of the nature referred to in the Section 80-HHE was included in the gross total income after set-off of brought forward business losses.

4. The CIT(A) erred in allowing the depreciation of Rs.6,33.792/- on account of software expenses in respect of STP units, without appreciating the fact that the depreciation claimed in respect of such units was adjustable against the income exempt u/s. 10A and not against the profits of other units.

5. The CIT(A) erred in directing the A.O. to delete the disallowance of depreciation of Rs. 1.61,18.819/- in the computation of total income, being the adjustment of depreciation not done by the assessee in respect of the income exempt u/s.l0A without appreciating the fact that in the computation of business income of the non-exempt units, the assessee has added back depreciation only to the extent of Rs.2.03.94.326/- while in the computation of depreciation as per the Income-tax Act. the assessee has exclude a higher depreciation of Rs.3,65,13.145/- pertaining to exempt units from the depreciation on the entire block of assets without furnishing any details in respect of the claim during the course of the assessment proceedings.

6(a) The C1T(A) erred in directing the A.O. to make adjustment in respect of the Arm's Length Price at Rs.8.18.792/- after verifying the correctness of the said III figure and its computation done, by the CIT(A) instead of the adjustment of I! Rs.j22,88.380/-done by the A.O. u/s.92(l) of the IT. Act."

(b) The CIT(A) ought to have held that the commission rate of 1 1.25% should have been applied to U.S. salaries of the seconded personnel instead of to the Indian salaries for the purpose of computing the Arm's Length Price.

(c) Length Price on the international transactions only in respect of the personnel who remained in employment for more than six months based on the assessee's claim that in the case of such personnel, fees were refundable by the respective recruiting agencies without appreciating the fact that such provision was applicable irrespective of whether the concerned personnel were in the U.S. or in India and was meant to re-coup the losses of the assessee till new appointments to the posts of the outgoing personnel were made and was not in any way related to the nature of the impugned international transactions.

7. For these and other grounds that may be urged at the time of hearing, the decision of the CIT(A) may be set aside on such above grounds and the order of the A.O. restored."

3. The Assessee is a company engaged in the business of development and marketing of software having units at SEEPZ, Noida, Ashok Plaza and Monali,

Chandigarh. The Assesse is the wholly owned subsidiary of Zensar Technologies Inc, USA. The assessee provides technical services outside India in connection with development and production of computer software. The assessee filed the return of income for A.Y. 2004-05 on 28/10/2004 declaring a total income at Nil after setting off brought forward business losses from previous years of Rs.2,36,35,058/- against business income and after adjusting the deduction claimed under section 80HHE of the Income Tax Act, 1961 (in short, “the Act”) against other income of Rs.1,53,80,174/-. The return was processed under section 143(1) on 11/07/2006. Subsequently the return was selected for scrutiny and the notice under section 143(2) was served on the assessee. Since the assessee had international transaction, a reference was made to the Transfer Pricing Officer (TPO). The TPO made a Transfer Pricing Adjustment of Rs,22,88,380/-, towards salary cost of employees who are seconded to the US Associated Enterprise (AE). The Assessing Officer while passing the assessment order made disallowance towards Non compete Fee of Rs.43,90,000/- and Employee Stock Options of Rs. 22,08,491 besides the above transfer pricing adjustment. The AO also treated a sum of Rs.1,48,43,768/- as income from other sources as against the treatement of interest and rental income as business income by the assessee. The AO also made an addition towards excess exemption claimed u/s.10A due to difference in depreciation between book depreciation and depreciation u/s.32 of the Act for Rs.1,61,18,819/-. The Assessing Officer further denied the deduction claimed under section 80HHE by the Assessee while concluding the assessment under section 143(3). The Assessee preferred appeal before the CIT(A) against the order of the Assessing Officer.

4. The Ld.CIT(A) gave relief to the assessee except for treatment of rent and interest 'Income as income from other sources' by Assessing Officer as against the treatment of the same as business income by the Assessee. With regard to the transfer pricing adjustment, the Ld.CIT(A) gave partial relief to the Assessee and upheld the addition for Rs.8,18,782/-. Aggrieved by the order of the Ld.CIT(A), the Revenue is in appeal before the ITAT.

5. **Amortisation of Non-compete Fee (Ground No.1)**

5.1 During the course of assessment proceedings, the Assessing Officer noticed that the Assessee has debited a sum of Rs.62,68,000/- towards non-compete fee. The assessee submitted that these are payments made to one Asia Logistics Ltd Rs.12,68,000 for non competing for one year for procuring business in China, and that Rs.50 lakhs was paid to Suntech Data Systems P Ltd towards non competing for 2 years. The Assessing Officer further noticed that the assessee has entered into agreements with these parties dated 19/02/2004 & 12/08/2003 respectively. The Assessing Officer held that the non compete fee cannot be fully allowed as a deduction and needs to be amortised over the period of non competing. Accordingly, the Assessing Officer allowed a sum of Rs.18,78,000/- as computed below and disallowed the balance of Rs.43,90,000/-.

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| (i) | Rs.12,68,000/- for 2 months | - | Rs. 2,11,330/- |
| (ii) | Rs.50 lakhs for 8 months | - | Rs.16,66,670/- |
| | | | Rs.18,78,000/- |

5.2 The Ld.CIT(A) deleted the disallowance by relying on the decision o the co-ordinate bench in Assessee's own case for A.Y. 1989-90 and on the decision of the Hon'ble Supreme Court in the case of Empire Jute Co. Ltd 124 ITR 1 (SC).

6. The Ld.DR before us submitted that the Ld.CIT(A) has merely relied on the order of the Tribunal of earlier years without discussing the facts for the current year. The Ld.DR furher submitted that the Assessing Officer has amortised the expenditure based on the agreements entered into and that this fact has not been considered or discussed by the Ld.CIT(A). The Ld.DR in this regard has placed reliance on the decision of the Supreme Court in the case of Madras Industrial Investment Corporation Ltd vs CIT (1997) 225 ITR 802(SC).

7. The Ld.AR submitted that the period of non competing is only one year and two years and that the issue is squarely covered by the decision of co-ordinate bench in Assessee's own case where it is held that –

> *"13.1 We have considered the rival submissions and have gone through the material available on record. In view of the fact that the restraint is for a period of two to three years and not more than five years, in our opinion, the CIT(A) has rightly taken the view that the payment is allowable. Such a view was also taken by the Madras High Court in CIT vs Late G.D. Naidur & Others (165 ITR 63. We, therefore, uphold the order of the CIT(A) on this issue and reject the revenue's ground."*

7.1 The Ld.AR further submitted that similar issue has been considered by the Hon'ble Supreme Court in the case of Taparia Tools Ltd vs JCIT (2015) 372 ITR 605 (SC) and that the Hon'ble Apex Court in the said case has distinguished the decision in the case of Madras Industrial Investment Corporation (supra).

8. We have heard the parties and perused the material on record. We notice that the Hon'ble Supreme Court in the case of Taparia Tools Ltd vs JCIT (supra) has considered a similar issue and held that –

*"11) Insofar as the first reason, namely, non-convertible debentures were issued for a period of five years is concerned, that is clearly not tenable. While taking this view, the AO clearly erred as he ignored by ignoring the terms on which debentures were issued. As noted above, there were two methods of payment of interest stipulated in the debenture issued. Debenture holder was entitled to receive periodical interest after every half year @ 18% per annum for five years, or else, the debenture holder could opt for upfront payment of ₹55 per debenture towards interest as one time payment. By allowing only 1/5th of the upfront payment actually incurred, though the entire amount of interest is actually incurred in the very first year, the AO, in fact, treated both the methods of payment at par, which was clearly unsustainable. By doing so, the AO, in fact, tampered with the terms of issue, which was beyond his domain. It is obvious that on exercise of the option of upfront payment of interest by the subscriber in the very first year, the assessee paid that amount in terms of the debenture issue and by doing so he was simply discharging the interest liability in that year thereby saving the recurring liability of interest for the remaining life of the debentures because for the remaining period the assessee was not required to pay interest on Civil Appeal Nos. 6366-6368 of 2003 and the borrowed amount.*

*12) The next question which arises for consideration is as to whether the assessee was estoppel from claiming deduction for the entire interest paid in the year in which it was paid merely because it had spread over this interest in its books of account over a period of five years. Here, the submission of learned counsel for the assessee was that there is no such estoppel, inasmuch as, the treatment of a particular entry (or for that matter interest entered in the instant case) in the books of accounts is entirely different from the treatment which is to be given to such entry/expenditure under the Act. His contention was that assessment was to be made in accordance with the provisions of the Act and not on the basis of entries in the books of accounts. His further argument was that had the assessee not claimed the payment of entire interest amount as tax in the income tax returns and had claimed deduction over a period of five years treating it as deferred interest payment, perhaps the AO would have been right in accepting the same in consonance with the accounting treatment which was given. However, learned counsel pointed out that in the instant case the assessee had filed the income tax return claiming the entire deduction which was allowable to it under the Civil Appeal Nos. 6366-6368 of 2003 and provisions of Section 36(1)(iii) of the Act as all the conditions thereof were fulfiled and, thus, it was exercising the statutory right which could not be denied.*

*13) We find that the High Court has taken into consideration the provisions of Section 36(1)(iii) of the Act and the conditions which are to be fulfilled for allowing the deduction on this account in the following words:*

*"...The term "interest" has been defined under Section 2(28A) of the Act. Briefly, interest payment is an expense under Section 36(1)(iii). Interest on monies borrowed for business purposes is an expenditure in a business [see 35 ITR 339 – Madras]. For claiming deduction under Section 36(1)(iii), the following conditions are required to be satisfied viz. the capital must have been borrowed; it must have been borrowed for business purpose and the interest must be paid. The word "Paid" is defined in Section 43(2). It means payment in accordance with the method followed by the assessee. In the present case, therefore, the word "Paid" in Section 36(1)(iii) should be construed to mean paid in accordance with the method of accounting followed by the assessee i.e. Mercantile System of accounting..."*

*Notwithstanding the aforesaid, the High Court chose to decline the whole deduction in the year of payment, thereby affirming the orders of the authorities below, by invoking the 'Matching Concept'. It is observed by the High Court that under the mercantile system of accounting, book profits are liable to be Civil Appeal Nos. 6366-6368 of 2003 and taxed and in order to determine the net income of an Accounting Year, the revenue and other incomes are to be matched with the cost of resources consumed (expenses). For this reason, in the opinion of the High Court, this matching concept is required to be done on accrual basis. As per the High Court, in this case, payment of ₹55 per debenture towards interest was made, which pertained to five years, and, thus, this interest of five years was paid in the first year. We are of the opinion that it is here the High Court has gone wrong and this approach resulted in wrong application of Matching Concept. It is emphasized once again that as per the terms of issue, the interest could be paid in two modes. As per one mode, interest was payable every year and in that case it was to be paid on six monthly basis @ 18% per annum. In such cases, the interest as paid was claimed on yearly basis over a period of five years and allowed as well and there is no dispute about the same. However, in the second mode of payment of interest, which was at the option of the debenture holder, interest was payable upfront, which means insofar as interest liability is concerned, that was discharged in the first year of the issue itself. By this, the assessee had benefited by making payment of lesser amount of interest in comparison with the interest which was payable under the first mode over a period of Civil Appeal Nos. 6366-6368 of 2003 and five years. We are, therefore, of the opinion that in order to be entitled to have deduction of this amount, the only aspect which needed examination was as to whether provisions of Section 36(1)(iii) read*

*with Section 43(ii) of the Act were satisfied or not. Once these are satisfied, there is no question of denying the benefit of entire deduction in the year in which such an amount was actually paid or incurred.*

*14) The High Court has also observed that it was a case of deferred interest option. Here again, we do not agree with the High Court. It has been explained in various judgments that there is no concept of deferred revenue expenditure in the Act except under specified sections, i.e. where amortization is specifically provided, such as Section 35-D of the Act.*

*15) What is to be borne in mind is that the moment second option was exercised by the debenture holder to receive the payment upfront, liability of the assessee to make the payment in that very year, on exercising of this option, has arisen and this liability was to pay the interest @ ₹55 per debenture. In Bharat Earth Movers v. Commissioner of Income Tax1, this Court had categorically held that if a business liability has arisen in the 1 (2000) 6 SCC 645 Civil Appeal Nos. 6366-6368 of 2003 and accounting year, the deduction should be allowed even if such a liability may have to be quantified and discharged at a future date. Following passage from the aforesaid judgment is worth a quote:*

*"The law is settled: if a business liability has definitely arisen in the accounting year, the deduction should be allowed although the liability may have to be quantified and discharged at a future date. What should be crtain is the incurring of the liability. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible. If these requirements are satisfied the liability is not a contingent one. The liability is in praesenti though it will be discharged at a future date. It does not make any difference if the future date on which the liability shall have to be disharged is not certain."*

*The present case is even on a stronger footing inasmuch as not only the liability had arisen in the assessment year in question, it was even quantified and discharged as well in that very accounting year.*

*16) Judgment in Madras Industrial Investment Corporation Limited v. Commissioner of Income Tax2 was cited by the learned counsel for the Revenue to justify the decision taken by the courts below. We find that the Court categorically held even in that case that the general principle is that ordinarily revenue expenditure incurred wholly and exclusively for the purpose of 2 (1997) 4 SCC 666 Civil Appeal Nos. 6366-6368 of 2003 and business is to be allowed in the year in which it is incurred.*

*However, some exceptional cases can justify spreading the expenditure and claiming it over a period of ensuing years. It is important to note that in that judgment, it was the assessee who wanted spreading the expenditure over a period of time and had justified the same. It was a case of issuing debentures at discount; whereas the assessee had actually incurred the liability to pay the discount in the yea r of issue of debentures itself. The Court found that the assessee could stil be allowed to spread the said expenditure over the entire period of five years, at the end of which the debentures were to be redeemed. By raising the money collected under the said debentures, the assessee could utilise the said amount and secure the benefit over number of years. This is discernible from the following passage in that judgment on which reliance was placed by the learned counsel for the Revenue herself:*

*"15.. The Tribunal, however, held that since the entire liability to pay the discount had been incurred in the accounting year in question, the assessee was entitled to deduct the entire amount of Rs.3,00,000 in that accounting year. This conclusion does not appear to be justified looking to the nature of the liability. It is true that the liability has been incurred in the accounting year. But the liability is a continuing liability which stretches over a period of 12 years. It is, therefore, a liability spread over a period of 12 years. Ordinarily, revenue expenditure which is incurred Civil Appeal Nos. 6366-6368 of 2003 and wholly and exclusively for the purpose of business must be allowed in its entirety in the year in which it is incurred. It cannot be spread over a number of years even if the assessee has written it off in his books over a period of years. However, the facts may justify an assessee who has incurred expenditure in a particular year to spread and claim it over a period of ensuing years. In fact, allowing the entire expenditure in one year might give a very distorted picture of the profits of a particular year. Thus in the case of Hindustan Aluminium Corporation Ltd. vs. CIT, (1982) 30 CTR (Cal) 363: (1983) 144 ITR 474 (Cal) the Calcutta High Court upheld the claim of the assessee to spread out a lump sum payment to secure technical assistance and training over a number of years and allowed a proportionate deduction in the accounting year in question.*

*16. Issuing debentures at a discount is another such instance where, although the assessee has incurred the liability to pay the discount in the year of issue of debentures, the payment is to secure a benefit over a number of years. There is a continuing benefit to the business of the company over the entire period. The liability should, therefore, be spread over the period of the debentures."*

*17) Thus, the first thing which is to be noticed is that though the entire expenditure was incurred in that year, it was the assessee who wanted the spread over. The Court was conscious of the principle that normally revenue*

*expenditure is to be allowed in the same year in which it is incurred, but at the instance of the assessee, who wanted spreading over, the Court agreed to allow the assessee that benefit when it was found that there was a continuing benefit to the business of the company over the entire Civil Appeal Nos. 6366-6368 of 2003 and period.*

*18) What follows from the above is that normally the ordinary rule is to be applied, namely, revenue expenditure incurred in a particular year is to be allowed in that year. Thus, if the assessee claims that expenditure in that year, the IT Department cannot deny the same. However, in those cases where the assessee himself wants to spread the expenditure over a period of ensuing years, it can be allowed only if the principle of 'Matching Concept' is satisfied, which upto now has been restricted to the cases of debentures.*

*19) In the instant case, as noticed above, the assessee did not want spread over of this expenditure over a period of five years as in the return filed by it, it had claimed the entire interest paid upfront as deductible expenditure in the same year. In such a situation, when this course of action was permissible in law to the assessee as it was in consonance with the provisions of the Act which permit the assessee to claim the expenditure in the year in which it was incurred, merely because a different treatment was given in the books of accounts cannot be a factor which would deprive the assessee from claiming the entire expenditure as a deduction. It Civil Appeal Nos. 6366-6368 of 2003 and has been held repeatedly by this Court that entries in the books of accounts are not determinative or conclusive and the matter is to be examined on the touchstone of provisions contained in the Act [See – Kedarnath Jute Manufacturing Co. Ltd. v. Commissioner of Income Tax (Central), Calcutta 3; Tuticorin Alkali Chemicals & Fertilizers Ltd., Madras v. Commissioner of Income Tax, Madras4; Sutlej Cotton Mills Ltd. v. Commissioner of Income Tax, Calcutta 5; and United Commercial Bank, Calcutta v. Commissioner of Income Tax, WB-III, Calcutta6].*

*20) At the most, an inference can be drawn that by showing this expenditure in a spread over manner in the books of accounts, the assessee had initially intended to make such an option. However, it abandoned the same before reaching the crucial stage, inasmuch as, in the income tax return filed by the assessee, it chose to claim the entire expenditure in the year in which it was spent/paid by invoking the provisions of Section 36(1)(iii) of the Act. Once a return in that manner was filed, the AO was bound to carry out the assessment by applying the 3 (1972) 3 SCC 252 4 (1997) 6 SCC 117 5 (1978) 4 SCC 358 6 (1999) 8 SCC 338 Civil Appeal Nos. 6366-6368 of 2003 and provisions of that Act and not to go beyond the said return. There is no estoppel against the*

*Statute and the Act enables and entitles the assessee to claim the entire expenditure in the manner it is claimed.*

*21) In view of the aforesaid discussion, we are of the opinion that the judgment and the orders of the High Court and the authorities below do not lay down correct position in law. The assessee would be entitled to deduction of the entire expenditure of ₹2,72,25,000 and ₹55,00,000 respectively in the year in which the amount was actually paid. The appeals are allowed in the aforesaid terms with no orders as to costs."*

9. In assessee's case, the agreement of non-competence is entered into for a period of one year and two years and the Assessee has incurred the liability towards the same in the year under consideration. Hence, in our considered view, the ratio laid down by the Apex Court is applicable in Assessee's case and, therefore, respectfully following the above decision of the Apex Court in Taparia Tools (supra), we uphold the decision of the Ld.CIT(A) in deleting the disallowance of non competence fees. This ground of the revenue is dismissed accordingly.

10. **ESOP EXPENSES (GROUND No.2):**

11. The Assessee has debited an amount of Rs.22.08 lakhs towards Employee Stock Option Expenses (ESOP) in the P&L Account. The Assessing Officer disallowed the same for the reason that the no option has been exercised during the year and that the Assessee did not provide any plausible reason for claiming the expenses as a deduction. The Ld.CIT(A) deducted the disallowance by relying on the decision of the Ld.CIT(A) in assessee's own case for A.Y. 2002-03. The Ld.CIT(A) further held that the Employee Stock Option expenses is an allowable deduction as the same is an ascertained liability.

12. Before us, the Ld.DR supported the order of the Assessing Officer and submitted that the Ld.CIT(A) is not correct in deleting the disallowance.

13. The Ld.AR submitted that it is a settled issue that the ESOP expenses are an allowable expenditure and in this regard relied on the following decisions:-

1. PCIT vs New Delhi Television Ltd 398 ITR 57 (Del)
2. C IT vs PVP Ventures Ltd (2012) 211 Taxman 554 (Madras)
3. CIT vs Biocon Ltd (2021) 430 ITR 151 (Karnataka)

14. We heard the rival submissions and perused the material on rcord. We notice that the Hon'ble Delhi High Court in the case of PCIT vs New Delhi Television Ltd (supra) has considered a similar issue and held that –

> *"4. The Special Bench ruling in Biocon Ltd. (supra) considered the matter rather elaborately and also examined all the previous decisions. It scrutinised different accounts of ESOPs and the points of time when they could have vested. The observations of the Special Bench in this regard, inter alia, are as follows (page 623 of 25 ITR (Trib)) :*
>
> > *"When we consider the facts of the present case in the backdrop of the ratio laid down by the Hon'ble Supreme Court in Bharat Earth Movers v. CIT [2000] 245 ITR 428 and Rotork Controls India (P.) Ltd. v. CIT[2009] 314 ITR 62 (SC), it becomes vivid that the mandate of these cases is applicable with full force to the deductibility of the discount on incurring of liability on the rendition of service by the employees. The factum of the employees becoming entitled to exercise options at the end of the vesting period and it is only then that the actual amount of discount would be determined, is akin to the quantification of the precise liability taking place at a future date, thereby not disturbing the otherwise liability which stood incurred at the end of the each year on availing of the services.*
> >
> > *As regards the contention of the learned Departmental representative about the contingent liability arising on account of the options lapsing during the vesting period or the employees not choosing to exercise the option, we find that normally it is provided in the schemes of ESOP that the vested options*

*that lapse due to non-exercise and/or unvested options that get cancelled due to resignation of the employees or otherwise, would be available for grant at a future date or would be available for being re-granted at a future date. If we consider it at micro level qua each individual employee, it may sound contingent, but if view it at macro level qua the group of employees as a whole, it loses the tag of 'contingent' because such lapsing options are up for grabs to the other eligible employees. In any case, if some of the options remain unvested or are not exercised, the discount hitherto claimed as deduction is required to be reversed and offered for taxation in such later year. We, therefore, hold that the discount in relation to options vesting during the year cannot be held as a contingent liability.*

*C. Fringe Benefit*

*. . . Act 2005, with effect from April 1, 2006. Memorandum explaining the provisions of the Finance Bill, 2005 highlights the details of the fringe benefits tax. It provides that : 'Fringe benefits as outlined in section 115WB, mean any privilege, service, facility or amenity directly or indirectly provided by an employer to his employees (including former employees) by reason of their employment'. Charging section 115WA of this Chapter provides that : 'In addition to the Income-tax charged under this Act, there shall be charged for every assessment year . . .'fringe benefit tax in respect of fringe benefits provided or deemed to have been provided by an employee to his employees during the previous year'. Section 115WB gives meaning to the expression 'fringe benefits'. Sub-section (1) provides that for the purposes of this Chapter, 'fringe benefits means any consideration for employment as provided under clauses (a) to (d). Clause (d), which is relevant for our purpose, states that: 'any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer free of cost or at concessional rate to his employees (including former employee or employees)' shall be taken as fringe benefit. The Explanation to this clause clarifies that for the purposes of this clause,—(/) 'specified security' means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and, where employees' stock option has been granted under any plan or scheme thereof, includes the securities offered under such plan or scheme. Thus it is discernible from the above provisions of the Act that the Legislature itself contemplates the discount on premium under ESOP as a benefit provided by the employer to its employee during the course of service. If the Legislature considers such discounted premium to the employees as fringe benefit or 'any consideration for employment', it is not open to argue contrary. Once it is held as ; consideration for employment, the natural corollary which follows is that such discount (/) is a expenditure; (ii) such expenditure is on account of an*

*ascertained (not contingent) liability; and (Hi) cannot be treated as a short capital receipt. In view of the foregoing discussion, we are of the considered opinion that discount on shares under the ESOP is an allowable deduction.*

*II. If yes, then when and how much ?*

*Having seen that the discount under ESOP is a deductible expenditure under section 37(1), the ne: question is that 'when' and for 'how much' amount should the deduction be granted ?*

*The assessee is a limited company and hence it is obliged to maintain its accounts on mercantile basis Under such system of accounting, an item of income becomes taxable when a right to receive it is final acquired notwithstanding the fact that when such income is actually received. Even if such income actually received in a later year, its taxability would not be evaded for the year in which right to receive was finally acquired. In the same manner, an expense becomes deductible when liability to pay arises irrespective of its actual discharge. The incurring of liability and the resultant deduction cannot be marred by mere reason of some difficulty in proper quantification of such liability at that stage. The very point incurring the liability enables the assessee to claim deduction under mercantile system of accounting. \ have noticed the mandate of the Hon'ble Supreme Court in Bharat Earth Movers [2000] 245 ITR 428 tl if a business liability has definitely arisen in an accounting year, then the deduction should be allowed that year itself notwithstanding the fact that such liability is incapable of proper quantification at that stage and is dischargeable at a future date. It follows that the deduction for an expense is allowable on incurring of liability and the same cannot be disturbed simply because of some difficulty in the proper quantification. A line of distinction needs to be drawn between a situation in which a liability is not incurred and situation in which the liability is incurred but its quantification is not possible at the material time. Whereas in the first case, there cannot be any question of allowing deduction, in the second case, deduction has to be allowed for a sum determined on some rational basis representing the amount of liability incurred."*

5. *Having regard to the above discussion, especially that the previous order dated July 12, 2016 in ITANo. 366 of 2016 had considered the same items of expenditure, under section 34, we are of the opinion that no question of law arises. The appeal is accordingly dismissed."*

15. Respectfully following the above decision we hold that the ESOP expenses be allowed as a deduction and therefore see no reason to interfere with the decision of the Ld.CIT(A). This ground is dismissed accordingly.

16. **<u>Deduction u/s 80HHE [Grounds 3 (a) to 3(b)]</u>**

17. The Assessee has claimed an amount of Rs.12,75,273 under section 80HHE after setting off earlier years brought forward business losses. The Assessee submitted before the Assessing Officer that as per section 80A, the deduction under section 80HHE shall be allowed against the gross total income and that though the assessee had Nil business income after set off of brought forward business loss, the Assessee is having capital gains & Income from Other Sources thereby the gross total income being positive, is entitled to claim deduction under section 80HHE. However, the Assessing Officer did not accept the contention of the assessee by holding that –

> *"The contentions raised by the assessee are perused. The assessee's contention for allowing deduction u/s 80HHE against income from Other Sources is not found tenable in view of the overriding effect of the provisions of section 80AB which state as under: .*
> ***"80AB. Deductions to be made with reference! to the income included in the gross total income.***
> *Where any deduction is required to be made or allowed under any section included in this Chapter under the heading "C.-Deductions in respect of certain incomes" in respect of any income of the nature specified in that section which is included in the gross total income of the assessee, then, notwithstanding anything contained in that section, for the purpose of computing the deduction under that section, the amount of income of that nature as computed in accordance with the provisions of this Act (before making any deduction under this Chapter) shall alone be deemed to be the amount of income of that nature which is derived or received by the assessee and which is included in his gross total income."*
> *In yiew of the above, as the profits of the business after set off of the earlier years losses reduces to 'NIL' it can be concluded that no deduction u/s 80HHE can be allowed to the assessee in the absence of the amount of income of that*

> *nature qualifying for computing deduction u/s 80HHE. Further, the set off of unabsorbed depreciation of Rs.26,27,443/- is also disallowed in view of the fact that the entire unabsorbed depreciation has been already set off in the preceding year.*"

The Ld.CIT(A) allowed the claim of deduction under section 80HHE by relying on the decision of the CIT(A) in Assessee's own case for A.Y. 2003-04. Aggrieved, the Revenue is contending the issue before the Tribunal.

18. The Ld.DR submitted that the Assessee is not entitled for deduction under section 80HHE since the business income of the assessee is NIL after adjusting the brought forward losses. In this regard, the Ld.DR placed reliance on the decision of the Hon'ble Supreme Court in the case of IPCA Laboratories vs DCIT reported in 266 ITR 521 (SC).

19. The Ld.AR on the other hand submitted that the issue is covered by the decision of the co-ordinate bench in Assessee's own case for A.Y. 2002-03 where it has been held that –

> *6.1. We find that in the assessment order dated 29/12/2004 u/s.143(3) of the Act, the ld. AO had computed the profits eligible for deduction u/s.80HHE of the Act at Rs.7,65,20,042/-. Since, the gross total income of the assessee was only Rs.2,05,57,787/-, the deduction u/s.80HHE of the Act was restricted to the said amount of gross total income. However, while computing the gross total income, the brought forward business loss of Rs.12,29,01,688/- from previous year was sought to be adjusted by the ld. AO against the business income. We find that provisions of Section 80HHE of the Act allows deduction of profit derived from the business of export out of India of computer software for providing all technical services outside India in connection with development or production of computer software. It is not in dispute that the assessee is eligible for deduction u/s.80HHE of the Act in the present case. As per Section 80HHE(3) of the Act, the said profit derived shall be the amount which bears to the profits of the business, the same proportion as the export turnover bears to the total turnover.*

*We find from the perusal of the provisions of Section 80HHE of the Act, as per Clause(d) of the explanation below the said Section, the starting point for computation of profits of the business is the profits of the business as computed under the head 'profits and gains of business or profession.' It is pertinent to note that Section 29 of the Act mandate that the business income shall be computed in accordance with the provisions contained in Section 30-43D of the Act. Hence, the profit qualifying for deduction u/s.80HHE of the Act is the profit of the current year. The set off of brought forward business loss is governed by the provisions of Section 72 of the Act and it has no relevance for this purpose. Hence, in our considered opinion, the eligible profits u/s.80HHE cannot be reduced by the brought forward business loss.*

*6.2. We find that the ld. CIT had held that the profits of the business for the year under consideration has to be reduced by the brought forward losses from earlier year for the purpose of computing profits eligible for deduction u/s.80HHE of the Act. The ld. DR before us placed reliance on the decision of the Hon'ble Madhya Pradesh High Court in the case of Vippy Solvex Products Ltd., vs. CIT reported in 273 ITR 107 and also on the decision of the Hon'ble Supreme Court in the case of IPCA Laboratories vs. DCIT reported in 266 ITR 521, in support of the contentions of the ld. CIT. We find there are two stages of computation of deduction u/s.80HHE of the Act. The first stage is the profits eligible for deduction u/s.80HHE has to be computed in the following formula:-*

*Profits of the business x export turnover Total Turnover*
*Total turnover*

*6.3. As stated supra, profits of the business is to be computed as per Section 29 of the Act which in turn stipulates that business income shall be computed in accordance with the provisions contained in Section 30- 43D of the Act. The second phase is the said deduction so computed above is to be restricted to the extent of gross total income as the same is to be allowed from gross total income. In the facts before the Hon'ble Madhya Pradesh High Court, in the second stage of computation, the gross total income was nil and therefore, no deduction u/s.80HHE of the Act was allowed. In the facts before the Hon'ble Supreme Court in Ipca Laboratories referred to supra, the loss from export of trading goods was higher than the profits of self-manufactured goods resulting into net negative income. The Hon'ble Supreme Court was not concerned with brought forward business loss as the issue is arising in the present case. Hence, the deduction u/s.80HHE of the Act was denied. Hence, it could be safely concluded that the two case laws relied upon by the ld. DR does not advance the case of the Revenue as they are factually distinguishable from the present case.*

*6.4. We find that the issue in dispute is squarely addressed by the decision of the Hon'ble Supreme Court in the case of Reliance Energy Ltd., in Civil Appeal No.1327 of 2021 with Civil Appeal No.1328 of 2021; Civil Appeal No.1329 of 221; Civil Appeal No.2537 of 2015; Civil Appeal No.1408 of 2021; Civil Appeal No.1508 and Civil Appeal No.1509 of 2021 dated 28/04/2021. We find that the facts of the case and the issue in dispute which went before the Hon'ble Supreme Court has been duly addressed in para 3 & 4 of the said decision. In that case, the Hon'ble Supreme Court was concerned with the deduction u/s.80IA of the Act. Based on the interpretation of Section 80IB and 80IA of the Act, it was held that in para 12 & 13 thereon that the profit eligible for deduction would be net profit made by the assessee from the eligible business and such deduction is to be allowed from gross total income. We find that similar view has been taken by the Hon'ble Jurisdictional High Court in the following cases:-*

*a) CIT vs. Tridoss Laboratories reported in 328 ITR 448*
*b) V.M.Salgaocar & Brothers (P) Ltd., vs. ACIT reported in 81 taxmann.com 357.*
*c) CIT vs. Eskay Knit (India) Pvt. Ltd., in Income Tax Appeal No.184 of 2007 dated 25/03/2010.*
*d) CIT vs. J.B.Boda & Co., Pvt. Ltd., in Income Tax Appeal No.3224 of 2009 dated 18/10/2010.*

*6.5. In the instant case, we find that if the set off of brought forward business loss was not taken into account, the assessee would have been entitled to deduction of the entire amount of profit eligible for deduction u/s.80HHE of the Act of Rs.7,65,2,042/-. But since the deduction under*

*80HHE of the Act is restricted to gross total income and such gross total income is to be computed after setting off the brought forward business losses, the assessee's claim of deduction got reduced. Hence, there cannot be any error in the ld. AO allowing deduction under 80HHE of the Act in the instant case. Hence no adjustment is warranted in the instant case as proposed by the ld. CIT.*

*6.6. We further find that the ld. DR vehemently placed reliance on the decision of Hon'ble Jurisdictional High Court in the case of Rohan Dyes and Intermediates Ltd., vs. CIT reported in 142 Taxman 503. In this case, the first issue which arose before the Hon'ble Court was similar to that as arose in the case of Ipca Laboratories Ltd., referred to supra coupled with further issue that if the combined net profit from the self-manufactured export and the trading export was the loss, then the deduction in respect of export incentives was to be allowed without setting off such net loss. We find that in this case also, the issue as arising in the present case of the assessee before us i.e. the computation of profit*

*eligible for deduction by setting off brought forward business loss, did not arise for consideration and therefore, the decision rendered in Rohan Dyes and Intermediates Ltd., also becomes factually distinguishable with that of the assessee case. Accordingly, we hold that the ld. CIT grossly held in holding with the profits of the business for the year under consideration has to be reduced by the brought forward losses from earlier year for the purpose of computing profit eligible deduction u/s.80HHE of the Act. Accordingly, the ground No.2(a), 2(b) by the assessee are allowed."*

19.1 The Ld.AR further submitted that for the purpose of computing the deduction under section 80HHE only the profits of the business before setting off of the brought forward loss to be considered and that the deduction under section 80HHE could be allowed against the "gross total income". Accordingly, it was argued that the deduction under section 80HHE cannot be denied on the ground that the Assessee is having NIL income under the head "profits and gains from income or profession". In this regard, the Ld.AR drew our attention to sub section (3) of section 80HHE. The Ld.AR also placed reliance on the decision of the Hon'ble Supreme Court in the case of CIT vs Reliance Energy Ltd (2022) 44 ITR 346 (SC) and also on the decision of the Bombay High Court in the case of V.M. Salgaonkar & Brother (P) Ltd vs ACIT (2015) 281 CTR 191 (Bombay).

20 We heard the parties & perused the material on record. We notice that the similar issue has been considered by the Hon'ble Supreme Court in the case of Reliance Energy Ltd (supra) where it is held that –

*9. The controversy in this case pertains to the deduction under Section 80-IA of the Act being allowed to the extent of 'business income' only. The claim of the Assessee that deduction under Section 80-IA should be allowed to the 5 (1986) 3 SCC 538 6 [2010] 328 ITR 448 (Bombay) extent of 'gross total income' was rejected by the Assessing Officer. It is relevant to reproduce Section 80AB of the Act which is as follows:*

> *"80AB. Deductions to be made with reference to the income included in the gross total income. — Where any deduction is required to be made or allowed under any section included in this Chapter under the heading "C. — Deductions in respect of certain incomes" in respect of any income of the nature specified in that section which is included in the gross total income of the assessee, then, notwithstanding anything contained in that section, for the purpose of computing the deduction under that section, the amount of income of that nature as computed in accordance with the provisions of this Act (before making any deduction under this Chapter) shall alone be deemed to be the amount of income of that nature which is derived or received by the assessee and which is included in his gross total income."*

*As stated above, Section 80AB was inserted in the year 1981 to get over a judgment of this Court in Cloth Traders (P) Ltd. (supra). The Circular dated 22.09.1980 issued by the CBDT makes it clear that the reason for introduction of Section 80AB of the Act was for the deductions under Part C of Chapter VI-A of the Act to be made on the net income of the eligible business and not on the total profits from the eligible business. A plain reading of Section 80AB of the Act shows that the provision pertains to determination of the quantum of deductible income in the 'gross total income'.*

*Section 80AB cannot be read to be curtailing the width of Section 80-IA. It is relevant to take note of Section 80A(1) which stipulates that in computation of the 'total income' of an assessee, deductions specified in Section 80C to Section 80U of the Act shall be allowed from his 'gross total income'. Sub-section (2) of Section 80A of the Act provides that the aggregate amount of the deductions under Chapter VI-A shall not exceed the 'gross total income' of the Assessee. We are in agreement with the Appellate Authority that Section 80AB of the Act which deals with determination of deductions under Part C of Chapter VI-A is with respect only to computation of deduction on the basis of 'net income'.*

*10. Sub-section (1) and sub-section (5) of Section 80-IA which are relevant for these Appeals are as under:*

> *"80-IA. Deductions in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development, etc.— (1) Where the gross total income of an assessee includes any profits and gains derived by an undertaking or an enterprise from any business referred to in sub-section (4) (such business being hereinafter referred to as the eligible business), there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a*

*deduction of an amount equal to hundred per cent. of the profits and gains derived from such business for ten consecutive assessment years.*

** **

*(5) Notwithstanding anything contained in any other provision of this Act, the profits and gains of an eligible business to which the provisions of sub- section (1) apply shall, for the purposes of determining the quantum of deduction under that sub-section for the assessment year immediately succeeding the initial assessment year or any subsequent assessment year, be computed as if such eligible business were the only source of income of the assessee during the previous year relevant to the initial assessment year and to every subsequent assessment year up to and including the assessment year for which the determination is to be made."*

*11. The essential ingredients of Section 80-IA (1) of the Act are:*

*a) the 'gross total income' of an assessee should include profits and gains;*

*b) those profits and gains are derived by an undertaking or an enterprise from a business referred to in sub-*

*section (4);*

*c) the assessee is entitled for deduction of an amount equal to 100% of the profits and gains derived from such business for 10 consecutive assessment years; and*

*d) in computing the 'total income' of the Assessee, such deduction shall be allowed.*

*12. The import of Section 80-IA is that the 'total income' of an assessee is computed by taking into account the allowable deduction of the profits and gains derived from the 'eligible business'. With respect to the facts of this Appeal, there is no dispute that the deduction quantified under Section 80-IA is Rs.492,78,60,973/-. To make it clear, the said amount represents the net profit made by the Assessee from the 'eligible business' covered under sub-section (4), i.e., from the Assessee's business unit involved in generation of power. The claim of the Assessee is that in computing its 'total income', deductions available to it have to be set-off against the 'gross total income', while the Revenue contends that it is only the 'business income' which has to be taken into account for the purpose of setting-off the deductions under Sections 80-IA and 80-IB of the Act. To illustrate, the 'gross total income' of the Assessee for the assessment year 2002-03 is less than the quantum of deduction determined under Section 80-IA of the Act. The Assessee contends that income from all other heads including*

*'income from other sources', in addition to 'business income', have to be taken into account for the purpose of allowing the deductions available to the Assessee, subject to the ceiling of 'gross total income'. The Appellate Authority was of the view that there is no limitation on deduction admissible under Section 80-IA of the Act to income under the head 'business' only, with which we agree.*

*13. The other contention of the Revenue is that sub-section (5) of Section 80-IA refers to computation of quantum of deduction being limited from 'eligible business' by taking it as the only source of income. It is contended that the language of sub-section (5) makes it clear that deduction contemplated in sub-section (1) is only with respect to the income from 'eligible business' which indicates that there is a cap in sub-section (1) that the deduction cannot exceed the 'business income'. On the other hand, it is the case of the Assessee that sub-section (5) pertains only to determination of the quantum of deduction under sub-section (1) by treating the 'eligible business' as the only source of income. It was submitted by Mr. Vohra, learned Senior Counsel, that the final computation of deduction under Section 80-IA for the assessment year 2002-03 as accepted by the Assessing Officer, was arrived at by taking into account the profits from the 'eligible business' as the 'only source of income'. He submitted that, however, sub-section (5) is a step antecedent to the treatment to be given to the deduction under sub- section (1) and is not concerned with the extent to which the computed deduction be allowed. To explain the interplay between sub-section (5) and sub-section (1) of Section 80-IA, it will be useful to refer to the facts of this Appeal. The amount of deduction from the 'eligible business' computed under Section 80-IA for the assessment year 2002-03 is Rs. 492,78,60,973 /-. There is no dispute that the said amount represents income from the 'eligible business' under Section 80-IA and is the only source of income for the purposes of computing deduction under Section 80-IA. The question that arises further with reference to allowing the deduction so computed to arrive at the 'total income' of the Assessee cannot be determined by resorting to interpretation of sub- section (5).*

14. *It will be useful to refer to the judgment of this Court relied upon by the Revenue as well as the Assessee. In Synco Industries (supra), this Court was concerned with Section 80-I of the Act. Section 80-I(6), which is in pari materia to Section 80-IA(5), is as follows:*

*" 80-I(6) Notwithstanding anything contained in any other provision of this Act, the profits and gains of an industrial undertaking or a ship or the business of a hotel or the business of repairs to ocean-going vessels or other powered craft to which the provisions of sub-section (1) apply shall, for the purposes of determining the quantum of deduction under sub-section (1) for the assessment*

*year immediately succeeding the initial assessment year or any subsequent assessment year, be computed as if such industrial undertaking or ship or the business of the hotel or the business of repairs to ocean-going vessels or other powered craft were the only source of income of the assessee during the previous years relevant to the initial assessment year and to every subsequent assessment year up to and including the assessment year for which the determination is to be made." It was held in Synco Industries (supra) that for the purpose of calculating the deduction under Section 80-I, loss sustained in other divisions or units cannot be taken into account as sub-section (6) contemplates that only profits from the industrial undertaking shall be taken into account as it was the only source of income. Further, the Court concluded that Section 80-I(6) of the Act dealt with actual computation of deduction whereas Section 80-I(1) of the Act dealt with the treatment to be given to such deductions in order to arrive at the total income of the assessee. The Assessee also relied on the judgment of this Court in Canara Workshops (P) Ltd., Kodialball, Mangalore (supra) to emphasize the purpose of sub-section (5) of Section 80-IA. In this case, the question that arose for consideration before this Court related to computation of the profits for the purpose of deduction under Section 80-E, as it then existed, after setting off the loss incurred by the assessee in the manufacture of alloy steels. Section 80-E of the Act, as it then existed, permitted deductions in respect of profits and gains attributable to the business of generation or distribution of electricity or any other form of power or of construction, manufacture or production of any one or more of the articles or things specified in the list in the Fifth Schedule. It was argued on behalf of the Revenue that the profits from the automobile ancillaries industry of the assessee must be reduced by the loss suffered by the assessee in the manufacture of alloy steels. This Court was not in agreement with the submissions made by the Revenue. It was held that the profits and gains by an industry entitled to benefit under Section 80-E cannot be reduced by the loss suffered by any other industry or industries owned by the assessee.*

*15. In the case before us, there is no discussion about Section 80-IA(5) by the Appellate Authority, nor the Tribunal and the High Court. However, we have considered the submissions on behalf of the Revenue as it has a bearing on the interpretation of sub-section (1) of Section 80-IA of the Act. We hold that the scope of sub-section (5) of Section 80- IA of the Act is limited to determination of quantum of deduction under sub-section (1) of Section 80-IA of the Act by treating 'eligible business' as the 'only source of income'."*

21. We notice that sub-section (3) of section 80HHE which deals with the manner of computation of eligible deduction states that for the purpose of deduction "Profits derived from the business" shall be considered and that sub section (1) of section 80A clearly states that in computing the total income of an assessee, there shall be allowed from his "gross total income", the deductions specified in sections 80C to 80U. We are, therefore, of the considered view that the ratio laid down by the Hon'ble Supreme Court in Reliance Energy (supra) is clearly applicable to Assessee's case also and accordingly the assessee has correctly claimed the deduction under section 80HHE from gross total income. Further, we notice that the co-ordinate bench in Assessee's own case has allowed the issue in favour of the Assessee considering the decision of the Apex Court. We, therefore, uphold the decision of the CIT(A) to allow the deduction under section 80HHE and this ground of the Revenue is dismissed.

22. **Depreciation on Software Expenses (Ground No.4)**

23. The Assessee contended before the Ld.CIT(A) that the Assessing Officer did not allow depreciation on the WDV of Software expenses which were treated as capital in nature for A.Y. 2002-03. The Assessee submitted the below working of depreciation in this regard.

| | **Rs.** |
|---|---|
| Disallowance of software expenses in Assessment year 2002-03 | 66,02,000 |
| Less : Depreciation granted vide order u/s 143(3) for assessment year 2002-03 | 39,61,200 |
| Less : Depreciation granted vide order u/s 143(3) For AY 2003-04 | 15,84,480 |
| Less: Depreciation @60% thereon | 6,33,792 |

The Ld.CIT(A) after considering the submission of the Assessee directed the Assessing Officer to grant the depreciation to Assessee.

24. The Ld.DR submitted that the depreciation claim for STPI & non-STPI should be segregated since the depreciation claimed in respect of STPI units was adjustable against the income exempt under section 10A and not against the profits of other units. During the course of hearing the Bench directed the Ld.AR to submit the workings giving the break-up of depreciation between STPI & non-STPI units. The Ld.AR submitted the workings as reproduced below:-

***Depreciation allocated on the basis of respective turnover of STPI and Non STPI units***

| | Turnover | % | Allocated depreciation | STPI units depreciation |
|---|---|---|---|---|
| Ashoka Plaza - STPI | 103,422,838 | 8.2% | 51,173 | 51,173 |
| The Orion - STPI | 360,673,260 | 28.5% | 180,343 | 180,343 |
| Bldg A - STPI | 287,642,678 | 22.7% | 143,826 | 143,826 |
| Non STPI | 515,803,002 | 40.7% | 257,910 | 257,910 |
| **Total** | **1,267,541,778** | **100.0%** | **633,792** | **375,882** |

25. We accordingly, remand the issue back to Assessing Officer with a direction to consider the above working and re-compute the exemption under section 10A considering the depreciation pertaining to STPI unit and allow the balance amount of Rs.2,57,910/- as a deduction while computing taxable income of the Assessee. This ground of the Revenue is allowed for statistical purposes.

26. **<u>Depreciation claim for the purpose of Section 10A exemption (Ground No.5)</u>**

27. During the course of assessment, the Assessing Officer noticed that Assessee has adjusted the difference between the depreciation as per Companies' Act & Income Tax Act in the computation of income, but did not make similar adjustment for the purpose of arriving at the exemption under section 10A. The Assessing Officer, therefore, treated the difference of Rs.1,61,18,819/- being difference between the book depreciation and depreciation as per the Act as not eligible for exemption under section 10A.

28. The Assessee submitted before the Ld.CIT(A) that considering the depreciation as per books and as per the Act will not result in any further addition to the total income and in his regard submitted the below workings:-

**<u>Illustration explain the impact on profits of business</u>**

| | | Profits of business on considering the adjustments on account of depreciation in respect of 10A units for 10A deduction | Profits of business without considering the adjustments on account of depreciation in respect of 10A units for 10A deduction |
|---|---|---|---|
| Profits and Gains from Business Profession Profit before Tax | | 158,662,527 | 158,662,527 |
| Less: Section 10A Benefit | (Note 1) | 130,695,380 | 146,8141,99 |
| NET PROFITS AFTER 10A BENEFIT | | **27,967,147** | **11,848,328** |
| Add : Depreciation as per Schedule XIV of the Companies Act (excluding STPI, ERP and Software WIP Depreciation) | | | (Annexure 46,928,338 9 to computation of ROI enclosed)(excluding STPI and Software WIP Depreciation) |
| Add: Depreciation as per Schedule XIV of the Companies Act (including STPI and | | (i.e. Rs.67,322,664 46,928,338 + Rs. 20,934,326) Depreciation | |

| | | | |
|---|---|---|---|
| excluding ERP Soft-Ware WIP depreciation)<br>Less: Depreciation u/s 32 of the Income Tax Act (excluding STPI)<br><br>Add : Disallowables<br><br>Less : Allowables & Exempt Income<br>Less: Items considered Separately<br>Add : Disallowance as per 143(3) order dated 28.12.2008<br><br>**Business Income as per 143(3) order dated 28.12.2008** | | pertaining to STPI units)<br><br>**48,640,751** | **48,640,751** |

29. The Ld.CIT(A) after considering the submission of the Assessee held that –

*"10.2. I have considered the above submission of the appellant. I agree with the same. The appellant, from its own computation as above is entitled to deduction / exemption u/s 10A to the extent of Rs.13,06,95,380/- as per IT Act in respect of STPI units. In the computation of income filed with the return of income the exemption u/s 10A has been claimed at Rs.14,68,199/- as under:*

| | | | |
|---|---|---|---|
| Profits and Gains of Business | | | **15,86,62,527** |
| Less : Exempt u/s 10A:STP units | | | |
| i) Ashoka Plaza Unit I, Pune | 3,37,07,572 | | |
| ii) Orion-Unit II,Pune | 4,69,33,824 | | |
| iii) Building A-Unit III, Pune | 6,61,72,803 | | |
| | -------------- | | |
| Less : Dividend Exemption u/s 10(33) | | 3,73,884 | **14,71,88,083** |
| | -------------- | ----------------- | |
| Net Profits Chargeable | | **1,14,74,444** | |
| | | **-----------------** | |

*10.3 However, the figure of Profits and Gains of business stated in the above computation at Rs.15,86,62,527/- is without adding back book depreciation and then reducing depreciation as per Income Tax Act. Similarly, the profits of business in respect of STPI units has also been computed without adjusting the book depreciation (adding it back) and thereafter reducing the depreciation as per*

*Income Tax Act. Hence if these figures are computed as per depreciation provided under the I.T. Act, the resultant deduction u/s 10A would be Rs.13,06,95,380/-, and the same will be reduced from the adjusted Profits and Gains of business (as against the figure of Rs.,15,86,62,527/-). The net result however will be the same as demonstrated by the appellant in the above chart. It is thus evident that the appellant's claim u/s 10A is correct and the A.O. was not justified in disallowing deduction u/s 10A to the extent of Rs.1,61,18,819/-. The addition on this account is deleted."*

30. Before us, the Ld.AR reiterated that the adjustment towards depreciation will not result in addition to total income and that the Ld.CIT(A) has rightly deleted the addition made by the Assessing Officer.

31. We heard the parties. From the perusal of the above workings as submitted by the Assessee before the lower authorities, it is clear that the adjustment of difference in depreciation to the profits eligible for exemption under section 10A will not result in any addition to total income. This is so because any increase or decrease to the profit due to the depreciation adjustment, i.e. adding back book depreciation & deduction of depreciation as per section 32 will be exempt under section 10A since there is no dispute that the Assessee is entitled to claim exemption under section 10A. Accordingly when the adjusted profit is also eligible for exemption under section 10A there is no question of making any addition towards the adjustment made to depreciation. We accordingly uphold the view taken by the CIT(A) in deleting the addition made in this regard. This ground of the Revenue is dismissed.

32. **Transfer Pricing Adjustment (Grounds Nos. 6(a) to 6(c))**

33. The TPO during the course of TP proceedings noticed that TP adjustment has been made on account of secondment of employees by Assessee to its AE. On the query raised by the TPO in this regard, the Assessee submitted that the Assessee sends personnel for specific projects and once the project is completed, the personnel return to India to join back Assessee's company. The Assessee further submitted that this is a normal practice in software industry. The Assessee also submitted that during the year under consideration 35 persons were sent to Zensas US and out of these 14 persons have rejoined Assessee in subsequent years. It was also submitted that they are not in the nature of recruitment services and in the earlier year TP adjustment has been incorrectly made applying placement agency rate of 11.25%. However, the TPO did not accept the submissions and proceeded to make an adjustment as under:-

| | |
|---|---:|
| Total number of skilled software personnel seconded to the US AE | 35 |
| Total salary of these 35 personnel [converted from US $756,730 AT Rs.44.50 per US $ | Rs.3,36,74,485 |
| 11.25% of the salary costs treated as arm's length price | Rs. 37,88,380 |
| Less : Human resource costs already allocated to the US AE | Rs. 15,00,000 |
| **Adjustment** | **Rs.22,88,380** |

34. Before the Ld.CIT(A), the Assessee made various submissions giving details of number of employees who left services and who rejoined Assessee, etc. The Ld.CIT(A) considered these submissions and gave relief to the Assessee with regard to 5 employees and also considered the India salary instead of US salary whereby the TP adjustment was reduced to Rs.8,18,782/-

35. The Ld.AR argued that the Assessee is not rendering placement services and making an adjustment applying placement agency rate is not justified. Further, Ld.AR submitted that the employees are deputed as part of normal software services rendered to AE and, therefore, no separate adjustment is warranted.

36. We heard the parties and perused the material on record. We notice that the Ld.CIT(A) has recomputed the TP adjustment taking into account the Indian salary and after excluding 5 employees, who have left within 6 months or who have rejoined Assessee. With regard to whether an adjustment is required, we are of the considered view that an adjustment is warranted for the benefit derived by the AE due to deployment of personnel for which the Assessee is required to be compensated. However, the benchmarking done by the TPO by applying the same rate of thirty party placement agency is not correct, since there are additional services / benefits provided by third party agencies while providing Recruitment Services whereas in Assessee's case, it is a pure deployment of personnel with regard to software services. Accordingly since there is need for an adjustment for the benefit derived we hold that the TP adjustment is to be revised to Rs.4,00,000/-. This ground of the Revenue is partly allowed.

37. Ground No.7 is general not warranting separate adjudication.

38. In the result, the appeal is partly allowed.

**Order pronounced in the open court on 19/04/2023.**

| **Sd/-** | **sd/-** |
|---|---|
| **(AMIT SHUKLA)** | **(PADMAVATHY S)** |
| **JUDICIAL MEMBER** | **ACCOUNTANT MEMBER** |

Mumbai, Dt : 19th April, 2023
Pavanan

**प्रतिलिपि अग्रेषितCopy of the Order forwarded to :**

1. अपीलार्थी/The Appellant ,
2. प्रतिवादी/ The Respondent.
3. आयकर आयुक्त CIT
4. विभागीय प्रतिनिधि, आय.अपी.अधि., मुबंई/DR, ITAT, Mumbai
6. गार्ड फाइल/Guard file.

BY ORDER,

//True Copy//

Asstt. Registrar / Senior Private Secretary
**ITAT, Mumbai**