IN THE INCOME TAX APPELLATE TRIBUNAL,
BANGALORE BENCH 'A'

BEFORE SHRI N.V VASUDEVAN, JUDICIAL MEMBER
AND
SHRI JASON P BOAZ, ACCOUNTANT MEMBER

ITA No.202 /Bang/2018
(Asst. Year – 2015-16)

Flipkart India Private Limited,
Essae Vaishnavi Summit,
No.6/B, 7th Main,
80 Feet Road, 3rd Block,
Koramangala Industrial Layout,
Bangalore – 560034,
PAN: AABCF8078M.

. Appellant

Vs.

Assistant Commissioner of Income-Tax,
Circle -3(1)(1),
Bangalore .Respondent

ITA No.693 /Bang/2018
(Asst. Year – 2015-16)
(By Revenue)

Revenue by : Shri C.H. Sundar Rao, CIT
Assesse by : Shri Percy Pardiwala, Advocate

Date of Hearing :10-04-2018
Date of Pronouncement :25 -04-2018

O R D E R

PER BENCH:

ITA No.202/Bang/2018 is an appeal by the Assessee and ITA No.693/Bang/2018 is an appeal by the Revenue. Both the appeals are directed

against the order dated 22.12.2017 of CIT(A)-3, Bengaluru, relating to AY 2015-16.

2. The Assessee is a company. During the relevant previous year it was engaged in the business of wholesale trader/distributor of books, mobiles, computers and related accessories. It filed a return of income for AY 2015-16 declaring loss of Rs.796,34,36,863/-.

3. The AO noticed that the Assessee was a wholesale dealer and acquired goods from various persons and was immediately selling the goods to retail sellers like M/S.WS Retail Services Pvt.Ltd. and others, who subsequently would sell those goods as sellers on internet platform under the name 'Flipkart.Com'. The AO further noticed that the Assessee has been purchasing goods at say Rs.100/- and selling them to the retailers at Rs.80/-. The purchases during the relevant previous year was Rs.10335,73,05,882/- and sales was Rs.9351,75,05,319/-. After excluding closing stock of unsold goods, the purchase and sales figure were as follows:

Purchases	Rs.10335,73,05,882
Less: Stock Unsold	Rs. 741,83,06,836
	Rs. 9593,89,99,046
Less: Sale value	Rs. 9351,75,05,319
Gross Loss	Rs. 242,14,93,727

4. The loss in terms of percentage was 2.52% of the cost of purchase value. The AO was of the view that the action of the Assessee in selling goods at less than cost price was not a normal business practice. He therefore called upon the Assessee to explain the purpose of selling goods at less than cost price.

5. The Assessee explained that sale through electronic form (e-commerce) as against the traditional sale through retail outlets had just begun in 2012. Since e-

commerce was in its nascent stage, it was very difficult to create trust and awareness of sale through e-commerce. The volume of sales was very low. One of the ways to increase volume of sales and attract buyers to e-commerce was to offer discounted prices. Higher volume of sales will lead to economies of scale.

6. On the above submission, the AO observed that the volume of sales of the Assessee was Rs.199.75 Crores in AY 2012-13 and had increased to Rs.9351.75 Crores in AY 2015-16. He observed that the volume of increase in sales was 45 times over a period of 3 years. He was therefore of the view that the plea of the Assessee that sale at discounted price to retailers was to increase volume of sales cannot be accepted.

7. The AO examined the Senior Vice-President and Finance Controller of the Flipkart Group Sri.Rajnish Baweja, by issuing summons to him by virtue of his power to summon witness u/s.131 of the Income Tax Act, 1961 (Act). The sum and substance of the statement of the Vice-President according to the AO was that the strategy of selling at a price lower (predatory pricing) than the cost price is to capture market share and to earn profits in the long run. According to the AO the benefit to the online buyer in the short run in the form of lower price is to create indirect benefit to the Assessee in the long run.

8. The AO thereafter concluded that the strategy of selling goods at lower than cost price was to establish customer goodwill and brand value in the long run and reap benefits in the later years. The AO in this regard referred to the fact that the Assessee during the previous year relevant to AY 2015-16 sold its shares at a huge premium (Equity shares of face value of Re.1/- was sold at a premium of Rs.18,999/- per equity shares) based on the valuation of those shares under the Discounted Cash Flow method(DCF Method). The DCF Method estimates the cash flows in future and uses appropriate discounting factors to arrive at the

current enterprise value. This was one reason for the AO to conclude that the strategy of incurring loss in the present was to reap benefit and profits in future by capturing E-Commerce market.

9. The AO thereafter concluded that the losses incurred by the Assessee was to create marketing intangible assets and therefore the loss to the extent it is created due to predatory pricing should be regarded as capital expenditure incurred by the Assessee and should be disallowed. The AO was however gracious in holding that the value of marketing intangibles should be considered as an asset used for the purpose of business for which the Assessee should be eligible to claim depreciation at 25%. In coming to this conclusion, the AO made the following observations in his order.:

> *"3.9. Assessee is following a business model of creating marketing intangible assets for long-term benefits. Various evidences of same can be summarized as under:*
>
> *A. Assessee sells its goods at a price lower than cost price*
>
> *B. Assessee has made losses consistently for the last 5 years. Yet it has a* ***high valuation****. What could be the rationale for high valuation other than the value of business model the marketing intangible and consumer goodwill.*
>
> *C. Assessee has not made profit even once till date. Its equity is being eroded. Yet it gets fresh investments from venture and angel investors at a high valuation. Fund managers and investors make detailed verification and analysis of the business model and approve a valuation. These fund managers accept that Assessee inspite of incurring losses, has generated huge marketing intangible, brand.*
>
> *3.10. At this juncture it is important to stress that the predatory pricing strategy of assessee is a long term strategy and hence the capital asset generated have enduring benefits for the company. Assessee has taken over the business "Flipkart Online Pvt.Ltd." by a slump sale in FY 2011-12. But prior to take over of the business, the business has been consistently making losses. The business has eroded its equity in losses; yet has attracted heavy investments from India and abroad. By accounting standards as well as provisions of Income Tax Act, expenditure made towards generation of capital assets should be capitalized. Assessee should not such e*xpenditure as revenue expenditure. *Hence the value of*

marketing intangibles should be disallowed and 25% only should be allowed as depreciation u/s.32 of IT Act, 1961."

10. The AO called upon the Assessee to explain why the difference between higher purchase price and lower selling price should not be inferred as a pricing strategy leading to enduring benefits; and hence leading to generation of capital asset. The Assessee replied that no part of purchases by an enterprise carrying on trading business can be considered as capital expenditure. The Assessee submitted that expenses on purchases in the business of wholesale cannot and does not create any asset of an enduring advantage.

11. The AO however concluded that the Assessee followed predatory pricing in order to create marketing intangibles and brand. According to him the enhanced valuations at which venture capitalists invest in the Assessee is based on intangibles generated by Assessee. Hence, selling at a price below prices is not an irrational economic behaviour. It is a clearly thought strategy to establish a monopoly in market by brand building by generating consumer goodwill. This strategy naturally leads to generation of intangible assets and enduring benefit.

12. Having come to a conclusion that the Assessee created intangible assets, the AO thereafter embarked upon method of valuation of intangibles. The first observation of the AO was that E-commerce business does not follow the traditional methods for earning income and hence assessment of income in the case of E-commerce business also cannot be done by following traditional methods. The AO referred to three approaches of valuation of intangibles prescribed by OECD in its convention of Base Erosion and Profit Shifting (BEPS) viz., cost approach, income approach and market approach. The AO adopted cost approach in which a reasonable profit margin is attributed to the cost of purchases and to the extent the profit is foregone by the Assessee was to be considered as the value of intangible. The following was the relevant observations of the AO:

"3. 18. For this purpose, the calculation of expense on intangible assets is as under:
(a) What would be the sale price of' good had it not followed predatory pricing and sold with a profit motive? Had assessee not followed predatory pricing, it would have sold the goods at market price and made a gross profit on cost of goods. Assessee's gross profit margin is (-) 2.52 % on cost (cost for assessee is Rs. 9593,89,99,046). The gross margin of comparable wholesalers is extracted from public databases and their average gross margin is to be computed, Say it is Y % on cost. Assessee's sale price in a fair business marketing situation would be cost plus + Y% of Rs.9593.89 crores.

(b) Assessee has shown sales of Rs. 9351,75,05,319. This sale price is at a discount and subsidizes generation of value for marketing intangibles. The cost incurred by assessee in generation of marketing intangibles is basically the difference in price between 'sale proceeds of any normal wholesaler in market" and sale proceeds of assessee in the same market". This is equal to:

marketing intangible =(100+Y) 9593,89,99,046/100-*
RS.9351,75,05,319

13. For the above purpose there was a need to find out average gross margin on cost for other wholesalers in the market. The AO took the database for wholesalers dealing in consumer and electronic goods. He took profit margins of companies whose turnover was above Rs.20 crores and whose revenue from trading was more than 75% of the total revenue. The search process yielded an average gross profit margin of 16.95%. This was compared with Assessee's profit margin of (-2.52%). The AO thereafter arrived at the total income of the Assessee as follows:

"3.20. The market average of gross profit margin for wholesalers is 16.95%. On perusal of the comparables, it is seen that none of comparable has an abnormally negative gross profit margin. It can be concluded that

these comparable wholesalers follow a profit-based business model. In any case, averaging irons out the differences in these market comparables. Had assessee not followed a predatory pricing policy, its (market average) sale price would have been Rs.9593,89,99,046 + (16.95% of Rs.9593,89,99,046) i.e. Rs. 11220,06,59,384. Assessees real sales is Rs. 9351 ,75,05,3 19. The reduction in sales due to following assessee's strategy of selling at a price lower than Cost, the difference of Rs. 1868,3 1,54,065 between the price at which the assessee is selling and the price the normal wholesaler would have sold is the value of expenses incurred by assessee towards cost of marketing intangibles in the year.

3.2 1. Assesses had cross-subsidized its marketing intangible and brand value with reduction in sale price. However, as already stated in great detail, marketing intangibles and brand value are assets. Any expense/cost incurred due on creation of the same is capital expenditure and has to be capitalized. Hence addition to the extent of Rs. 1868.31,54,065 is made on account of intangibles. Hence depreciation on intangibles is allowed 25 % of this amount. i.e. Rs.284.01,49.213/- and the balance is add the returned income. Hence the addition is ***(Rs. 1868,31,54,065 - Rs. 467,07,88,5 16) Rs. 1401,23,65,549.***

4. Further a similar capitalization was made in A.Y 2012-13, A.Y 2013 - 14 and AY 20 1415 the assessee company is eligible for depreciation on these capital asset in the current year as follows.

A.Y:2012-13 - Rs. 8,18,81.560

A.Y:2013-l4 - Rs. 45,14,69,521

A.Y:2014-15 - Rs. 143,22,15,931

After allowing the above deduction for AN 2012-13, 2013-14 and 2014-15 the addition to be made works out as under:

	1401,23,65,549
Less: Amortisation of A.Y: 2012-13	8,18,81,560
Less: Amortisation of A.Y: 2013-14	45,14,69,521
Less : Amortisation of AY 2014-15	143,22,15,931
Balance Addition	**1204,67,98,537**

Further as the assessee has furnished in accurate particulars of income penalty proceedings U/s 271(1)(c) are initiated separately.

The amount of Rs. 1204,67,98,537 as computed above is added to assessee's declared income and taxable income of assessee company is computed as under.

Loss as per Return of Income	**(-)796,34,36,865**
Add: Addition discussed in above	1204,67,98,537
Total Assessed Income	**408,33,61,672**
Tax thereon @30%	122.50,08,502
SC @ 5%	12,25,00,850
EC@ 3%	3,67,50,255
Total Tax Payable	**138,42,59,607**
Less: TDS	10,38,86,679
Balance Tax Payable	**128,03,72,928**
Add: Int. u/s. 234B	8,96,26,105
Balance tax Payable	**136,99,99,033**

Issue demand notice and penalty notice accordingly."

14. Aggrieved by the order of the AO, the Assessee preferred appeal before CIT(A). The CIT(A) confirmed the order of the AO. The CIT(A) in exercise of his powers of enhancement u/s.251(2) of the Act also withdrew depreciation of 25% on the intangible assets allowed by the AO while computing total income, for the reason that though the Assessee incurred expenses for creating intangible assets but was not owner of the intangible. In doing so, he did not give notice to the Assessee before exercising power of enhancement which he was bound to do u/s.251(2) of the Act. Further the CIT(A) in coming to the aforesaid conclusion relied on ground No.4(e) raised by the Assessee in the grounds of appeal, which reads thus:

Ground No.4 (e): "The learned AO failed to appreciate the fact that during the year under consideration, the appellant was not owning any Brand/Intellectual Property (transferred by way of slum sale in FY 2012-13, also disclosed in the financial statement for AY 2012-13 that are available in the learned AO's files for verification) and the Appellant was only engaged in the business of wholesale trading."

15. According to the CIT(A) in the above ground of appeal the Assessee has admitted that it sold intellectual property/brand in a slum sale in FY 2012-13 to M/S.Flipkart Internet Pvt.Ltd. This is a complete distortion of facts. If one reads Ground No.4(e) there is no admission of any ownership of intangible property/brand or its transfer in FY 2012-13 in a slump sale. For the sake of ready reference, we reproduce paragraph 6.5 of the CIT(A)'s order:

> *"6.5 In relation to ground of appeal 4(e), the appellant has also argued that it does not own any brand/intellectual property as the same was transferred in a slump sale in FY 2012-13 to M/s Flipkart Internet Pvt Ltd. The sale included business relating to Information Technology Platform along with brand name, trademark and support services. This argument of the appellant would not have any material impact on the issue of disallowance made by the AO in the case under consideration. The appellant belongs to Flipkart group and as per appellant the sale of brand etc is to a related party. Since the brand including Flipkart getting promoted by the business strategy of the appellant is not owned by the appellant and goodwill generated for the same is also not accruing to it then the expenditure to that extent needs to be considered for non-business purposes as the intangible generated would not he benefitting the appellant but the other person. In view of this the appellant would not be eligible to claim any depreciation on the value of intangible generated."*

16. Thereafter the CIT(A) gave certain directions in the matter of quantification of the value of intangible and the addition to be made to the total income. The revenue is aggrieved by these directions as this will reduce the profit margin on cost of purchases while working out the valuation of intangibles and therefore the revenue has preferred appeal against that part of the CIT(A)'s order. The Assessee is aggrieved by the order of the CIT(A) in its conclusion that the Assessee incurred expenses for creating intangibles and those expenses are capital expenditure and have to be added to the total loss declared by the Assessee, the Assessee has preferred appeal against the order of the CIT(A).

17. The Hon'ble Karnataka High Court in W.P.No.6533 of 2018 (T-IT) by its order dated 15.2.2018 has directed the Tribunal to hear the appeal filed by the Assessee on 9.4.2018 itself on which date the appeal was fixed for final hearing. The Hon'ble High Court has directed the parties not to seek any adjournment of hearing and conclude the hearing on the given date. The Hon'ble High Court has also directed that the Tribunal shall decide the appeal within 3 months from 15.2.2018.

18. First we shall take up for consideration the appeal by the Assessee. The learned counsel for the Assessee submitted that the manner in which the revenue authorities have proceeded to determine the total income of the Assessee is not in accordance with the provisions of the Act. In this regard he submitted that Income under the head "Income from Business or Profession" has to be computed in accordance with Sec.28 to Sec.44DB of the Act. The Starting point of computation of income from business has to be therefore the sales as recorded by the Assessee in its books of accounts. He drew our attention to the fact that the sales figure as per the books of accounts of the Assessee was Rs. 9351,75,05,319/-. It is not the case of the AO that the figures disclosed in the books of accounts are not true or correct. It was submitted by him that in such circumstances, the AO cannot disregard the books of accounts and compute income. He submitted that books of accounts of the Assessee have not been rejected. In such circumstances the AO cannot resort to a process of estimating income of the Assessee.

19. The learned counsel for the Assessee referred to the decision of the Hon'ble Supreme Court in the case of CIT Vs. Shoorji Vallabhdas & Co. 46 ITR 144 (SC). The Hon'ble Supreme Court was dealing with a case relating to AY 1948-49 corresponding to the previous year ending 31.3.1948. The Assessee was managing agent of two shipping companies and was entitled to receive commission at 10% of the freight received as commission. For the relevant

previous year the books of accounts were credited with the commission receivable from the two shipping companies. In 1947, the Assessee floated two private limited companies. These two companies were appointed as the Managing Agents for the two shipping companies for which the Assessee acted as Managing Agents on the same terms on which the Assessee acted as Managing Agents. The shareholders of the two companies for which the Assessee was acting as Managing Agents agreed to two private limited companies floated by the Assessee but at a reduced Agency commission of 2.50% of the freight received. On 30.12.1947 the two companies for which the Assessee acted as managing agents agreed to the two private limited companies floated by the Assessee to act as managing agents at 2.50% commission on freight received. As a result, the assessee- firm gave up 75 per cent of its earnings during the relevant years of account. In the assessment which followed, the ITO and the AAC came to the conclusion that the amount of larger commission had already accrued during the previous year ending 31st March, 1948, and was thus assessable. Assessee made an alternate claim that the amount given up was also claimed by the assessee-firm as an expenditure under s. 10(2)(xv) of the Indian IT Act, but was disallowed. On appeal to the Tribunal, the majority view of the Tribunal was that even though the actual reduction took place after the year of account was over, there was, in fact, an agreement to reduce the commission even during the currency of the account year, and the larger income neither accrued nor was received by the assessee-firm. In accordance with the opinion of the President, the assessment was reduced by deleting the extra commission from the computation. The Hon'ble High Court agreed with the majority view of the Tribunal and held that the larger sums cannot be regarded as income of the Assessee for the relevant previous year. On further appeal to the Hon'ble Supreme Court on a certificate by the Hon'ble High Court as a fit case for reference u/s.66A(2) of the Income Tax Act, 1922 (1922 Act), the Hon'ble Supreme Court held Income-tax is a levy on income. No doubt, the IT Act takes into account two points of time at which the liability to tax is attracted,

viz., the accrual of the income or its receipt; but the substance of the matter is the income. If income does not result at all, there cannot be a tax, even though in book- keeping, an entry is made about a "hypothetical income", which does not materialise. Where income has, in fact, been received and is subsequently given up in such circumstances that it remains the income of the recipient, even though given up, the tax may be payable. Where, however, the income can be said not to have resulted at all, there is obviously neither accrual nor receipt of income, even though an entry to that effect might, in certain circumstances, have been made in the books of account. According to him therefore the revenue cannot bring to tax “hypothetical income” by assuming that the Assessee incurred expenses on creation of intangibles/brand and those expenses are capital in nature and cannot be allowed as deduction while computing income.

20. He placed reliance on the decision of the Hon’ble Supreme Court in the case of CIT Vs. Calcutta Discount Co. Ltd., 91 ITR 8 (SC). In the aforesaid decision the facts were that the assessee-company floated a subsidiary company during the relevant previous year and transferred to that subsidiary company various shares held by it. In return the subsidiary company transferred to the assessee-company its shares of the value of Rs. 1,38,81,173. The book value of shares transferred by the assessee-company to its subsidiary was Rs. 1,66,69,391. Thus, the assessee-company sustained a loss of Rs. 27,02,398 but it did not claim that loss in the return on the ground that the transfer in question was made to its own subsidiary. The ITO valued the shares transferred by the assessee-company to its subsidiary at the market rate and on that basis came to the conclusion that the assessee-company must be deemed to have made a profit of Rs. 1,02,40,546. The action of the revenue authorities was not accepted by the tribunal and the Hon’ble High court. On further appeal by the revenue the Hon’ble Supreme Court held that the authorities under the Act have come to the conclusion that the transaction between the assessee and its subsidiary company was a bona fide transaction and the assessee had not made any secret profits out of the transaction

in question. It may be that the assessee had transferred its valuable shares at cost price to its subsidiary in order to so arrange its affairs as to reduce its tax burden. It is a well accepted principle of law that an assessee can so arrange his affairs as to minimise his tax burden. Hence, if the assessee in this case has arranged its affairs in such a manner as to reduce its tax liability by starting a subsidiary company and transferring its shares to that subsidiary company and thus forgoing part of its own profits and at the same time enabling its subsidiary to earn some profits, such a course is not impermissible under law. When one trader transfers his goods to another trader at a price less than the market price, the taxing authority cannot take into consideration the market price of those goods, ignoring the real price fetched. Now this position of law will stand modified after insertion of provisions of Sec.40A(2)(a) of the Act which lays down that if the parties are related to each other than the fair price paid for the goods can be scrutinized by the revenue. Also it needs to be noted that none of the transactions of the Assessee either purchase or sale is from or to a related party.

21. The learned counsel for the Assessee placed reliance on the decision of the Hon'ble Supreme Court in the case of CIT Vs. A.Raman & Co. 67 ITR 11 (SC). The facts in the aforesaid decision was that the assessees, M/s A. Raman & Co., (a partnership firm) were dealers in "mill stores". In the course of their business they sell "mill stores" to other dealers including two concerns trading in the names of M/s A.M. Shah & Co. M/s R. Ambalal & Co., which are owned by the HUFs, managers of which are the only partners of the assessees. The case of the revenue was that the assessees, their partners and their individual HUFs had contrived to divert profits of the assessees to their respective HUFs and had tried to "evade proper taxation". The Hon'ble Supreme Court held:

> *"The plea raised by the ITO is that income which could have been earned by the assessees was not earned, and a part of that income was earned by the HUFs. That according to the ITO was brought about by "a subterfuge or contrivance". Counsel for the CIT*

> *contended that if by resorting to a "device or contrivance", income which would normally have been earned by the assessee is divided between the assessee and another person, the ITO would be entitled to bring the entire income to tax as if it had been earned by him. But the law does not oblige a trader to make the maximum profit that he can out of his trading transactions.* ***Income which accrues to a trader is taxable in his hands : income which he could have, but has not earned, is not made taxable as income accrued to him.*** *By adopting a device, if it is made to appear that income which belonged to the assessee had been earned by some other person, that income may be brought to tax in the hands of the assessee, and if the income has escaped tax in a previous assessment a case for commencing a proceeding for reassessment under s. 147 (b) may be made out. Avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed is not prohibited. A taxpayer may resort to a device to divert the income before it accrues or arises to him. Effectiveness of the device depends not upon considerations of morality, but on the operation of the IT Act. Legislative injunction in taxing statutes may not, except on peril of penalty, be voted, but it may lawfully be circumvented." (emphasis supplied)*

22. The learned counsel placed reliance on the decision of the Hon'ble Karnataka High Court in the case of A.Khadar Basha Vs. ACIT (2015) 232 Taxman 434(Karn.). This decision was rendered in the context of provisions of Sec.40A(2) of the Act. The facts of the case were that the assessee purchased 139.24 MT of rice bran from M/s. Nicko Agro Industries, Omalur for a total sum of Rs.5,41,695/-. The average purchase price comes to Rs.3,890/- per MT. During the same year, the assessee sold 408.495 MT of rice bran to M/s. Nicko Agro Industries for a sum of Rs.9,30,080/- and the average selling price comes to Rs.2,277/- per MT. The Assessing Authority was of the view that the assessee purchased rice bran from M/s.Venkata Padmavathi Paddy & Rice, Nellore at a higher rate and sold the rice bran to M/s. Nicko Agro Industries at a very low rate. By such sales, the assessee reduced the profit and passed on the benefit to this concern, which also operates from the adjacent premises. Therefore, the Assessing authority proceeded under Section 145(3) of the Income tax Act and rejected the accounts maintained by the assessee. Thereafter, he proceeded to

value 408.495 MT of rice bran sold by him at the rate of Rs.3,890/- per MT based on the average purchase price and thus the difference was arrived at in a sum of Rs.6,58,965/- and that was treated as an additional income of the assessee and taxed. The Hon'ble Karnataka High Court held on the correctness of the action of the Revenue authorities as follows:

> *"4. We have heard the learned counsel appearing for the parties. The Apex Court in the case of Commissioner of Income-Tax, West Bengal V/s. Calcutta Discount Co. Ltd., reported in 1973(91) ITR 8 has held that "where a trader transfers his goods to another trader at a price less than the market price and the transaction is a bonafide one, the taxing authority cannot take into account the market price of those goods, ignoring the real price fetched to ascertain the profit from the transaction. An assessee can so arrange his affairs as to minimize his tax burden.*
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> *5. Similarly, the Gujarat High Court in the case of Commissioner of Income-Tax, Gujarat Vs. Keshavlal Chandulal reported in 1966(LIX) ITR 120 has observed that "where a person disposes of his goods at a lesser value than their market price, or at a concessional price, there is nothing in the income tax law which compels him to sell at a price which is the price realisable in the market.*
>
> *6. The only exception in this rule is, if the goods fall under Section 40(A)(2)(a) where there exists a relationship as set-out in the said provision between the parties. It is not the case of the Department that though the shops are adjoining each other, they are related in any manner. That provision is not invoked."*

23. The learned counsel for the Assessee pointed out that the facts of the Assessee's case are identical to the case decided by the Hon'ble Karnataka High Court in as much as the retailers to whom the Assessee sold its goods were unrelated parties and the provisions of Sec.40A(2)(a) of the Act were not attracted.

24. His submission on the basis of the aforesaid judicial pronouncements is that what can be taxes is only income that accrues or arises as laid down in Sec.5 of the Act. Nothing beyond Sec.5 of the Act can be brought to tax. His

submission was that there was nothing to show accrual of income so as to disregard the loss declared by the Assessee in the return of income filed. His further submission was that indirectly the AO has attempted to apply the provisions of Sec.92 of the Act. He submitted that the provisions of Sec.92 and chapter X of the Act, applies only to transactions between related parties and where one of the party to the transaction is a non-resident. He pointed out that in the present case the retailers to whom the Assessee sold goods were unrelated parties and therefore there was no question of invoking either the provisions of Sec.92 or invoking the rationale behind those provisions. Even domestic transfer pricing provisions u/s.92(2A) of the Act are not applicable as the Assessee has not undertaken any transaction with a related party as laid down in Sec.40A(2)(b) of the Act. Besides the above the domestic Transfer Pricing provisions are applicable to the following Domestic transactions only viz., (i) Any expenditure u/s 40A(2)(b); (ii) Any transactions referred to in S. 80A, (iii) Transactions referred to u/s 80IA(8) and 80IA(10); (iv) Transactions referred to under S.10AA or (v) Any others as maybe prescribed. It was submitted that none of the above conditions exist in the case of the Assessee and therefore the action of the revenue authorities cannot be sustained.

25. His next submission was that wherever the legislature wanted to tax income not earned, it had made specific provisions in the Act by way of deeming fiction. In this regard he drew attention to certain statutory provisions.

> *(i)* ***Sec.43CA****(1) Where the consideration received or accruing as a result of the transfer by an assessee of an asset (other than a capital asset), being land or building or both, is less than the value adopted or assessed or assessable by any authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed or assessable shall, for the purposes of computing profits and gains from transfer of such asset,* ***be deemed*** *to be the full value of the consideration received or accruing as a result of such transfer.*

(ii) Sec.45(4) The profits or gains arising from the transfer of a capital asset by way of distribution of capital assets on the dissolution of a firm or other association of persons or body of individuals (not being a company or a co-operative society) or otherwise, shall be chargeable to tax as the income of the firm, association or body, of the previous year in which the said transfer takes place and, for the purposes of section 48, the fair market value of the asset on the date of such transfer ***shall be deemed*** *to be the full value of the consideration received or accruing as a result of the transfer.*

(iii) Section 50C(1) Special provision for full value of consideration in certain cases.*(1) Where the consideration received or accruing as a result of the transfer by an assessee of a capital asset, being land or building or both, is less than the value adopted or assessed or assessable by any authority of a State Government (hereafter in this section referred to as the "stamp valuation authority") for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed or assessable] shall, for the purposes of section 48,* ***be deemed to be the full value of the consideration received or accruing as a result of such transfer.***

26. His submission was that in the absence of such a specific deeming provision, the revenue authorities do not have power to consider revenue not earned as income of an Assessee. His submission was that what the revenue authorities have sought to do in the present case was to bring to tax revenue which was not earned by the Assessee as income of the Assessee without the authority of law.

27. The learned counsel drew attention to the decision of the Hon'ble Supreme Court in the case of CIT Vs. S.C.Kothari 82 ITR 794 (SC) wherein the Hon'ble Supreme Court has explained as to how the AO should compute income. He relied on the following observations of the Hon'ble Court:

"Now while s. 10(1) of the Act of 1922 imposes a charge on the profits or gains of a business it does not provide how these profits are to be computed. Sec. 10(2) enumerates various items which are admissible as deductions. They are, however, not exhaustive of all allowances which can be made in ascertaining the profits of a business taxable under s. 10(1). It is undoubtedly true that profits and gains which are liable to to be taxed under s. 10(1) are what are understood to be such under ordinary commercial principles. The loss for which the deduction is claimed must be one that

springs directly from the carrying on of the business and is incidental to it. If this is established the deduction must be allowed provided that there is no provision against it, express or implied, in the Act (See Badridas Daga vs. CIT (1958) 34 ITR 10). In that case loss sustained by the business by reason of embezzlement by an employee was held to be an admissible deduction under s. 10(1) although it did not fall within s. 10(2)(xi) of the Act of 1922. Indeed profits cannot be computed without deducting the loss and permissible expenses incurred for the purpose of the business."

28. His submission was that the AO in the present case by enhancing the sale price and reducing from the sale price the actual sale price has arrived at the income of the Assessee and in the process has completely ignored the deductions while computing total income to which the Assessee is entitled to.

29. His next argument was that even assuming that the Assessee has incurred expenses in creating intangibles/brands, the same is allowable as revenue expenditure and such expenditure cannot be regarded as capital expenditure. In this regard he relied on the decision of the Hon'ble Karnataka, Gujarat and Delhi High Courts in the following cases wherein a view has been taken that expenses incurred for developing brand is not capital expenditure:

(i) (*2013) 217 Taxman 95 (Karn.) CIT Vs. Indo Nissin Foods Ltd.*
(ii) *308 ITR 263 (Guj.) DCIT Vs. Core Healthcare Ltd.*
(iii) *(2012) 210 Taxman 161 (Delhi)(Mag.) CIT Vs. Modi Revlon (P) Ltd.*

30. It was also submitted by him that the test of enduring benefit was held by the Hon'ble Supreme Court in the case of Empire Jute Co.Ltd. 124 ITR 1(SC) to be not a conclusive test to determine whether an expenditure is capital or revenue. The facts of the case before the Hon'ble Supreme Court was that the Assessee was a manufacturer of jute and a member of the Indian Jute Mills Association. The Association resolved that all members of the Association will work only specified hours. The Association permitted allowing transfer of working hours or loom hours among the signatories to the agreement. Assessee purchased loom

hours from four different jute manufacturers. The question before the Court was as to whether the Expenditure incurred on the purchase of loom hours was capital expenditure or revenue expenditure. The Hon'ble Court held that the Assessee merely obtained an advantage of more working time and no enduring benefit was obtained by the assessee and therefore the expenditure incurred was a revenue expenditure. Our attention was drawn to the following passage of the said judgment:

> *"The decided cases have, from time to time, evolved various tests for distinguishing between capital and revenue expenditure but no test is paramount or conclusive. There is no all-embracing formula which can provide a ready solution to the problem; no touchstone has been devised. Every case has to be decided on its own facts, keeping in mind the broad picture of the whole operation in respect of which the expenditure has been incurred. But a few tests formulated by the Courts may be referred to as they might help to arrive at a correct decision of the controversy between the parties. One celebrated test is that laid down by Lord Cave L.C. in Atherton vs. British Insulated & Helsby Cables Ltd. (1925) 10 Tax Cases 155 (HL), where the learned Law Lord stated :*
>
> > *"....when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital."*
>
> *This test, as the parenthetical clause shows, must yield where there are special circumstances leading to a contrary conclusion and, as pointed out by Lord Radcliffe in Commr. of Taxes vs. Nchanga Consolidated Copper Mines Ltd. (1965) 58 ITR 241 (PC) : TC16R.991, it would be misleading to suppose that in all cases, securing a benefit for the business would be, prima facie, capital expenditure "so long as the benefit is not so transitory as to have no endurance at all".* ***There may be cases where expenditure, even if incurred for obtaining advantage of enduring benefit, may, none the less, be on revenue account and the test of enduring benefit may break down. It is not every advantage of enduring nature acquired by an assessee that brings the case within the principle laid down in this test. What is material to consider is the nature of the advantage in a commercial sense and it is only where the advantage is in the capital field***

> ***that the expenditure would be disallowable on an application of this test. If the advantage consists merely in facilitating the assessee's trading operations or enabling the management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue account, even though the advantage may endure for an indefinite future. The test of enduring benefit is, therefore, not a certain or conclusive test and it cannot be applied blindly and mechanically without regard to the particular facts and circumstances of a given case.*** *But even if this test were applied in the present case, it does not yield a conclusion in favour of the Revenue. Here, by purchase of loom hours no new asset has been created. There is no addition to or e*xpansion of the profit-making apparatus of the assessee. *The income-earning machine remains what it was prior to the purchase of loom hours. The assessee is merely enabled to operate the profit making structure for a longer number of hours. And this advantage is clearly not of an enduring nature. It is limited in its duration to six months and, moreover, the additional working hours per week transferred to the assessee have to be utilised during the week and cannot be carried forward to the next week. It is, therefore, not possible to say that any advantage of enduring benefit in the capital field was acquired by the assessee in purchasing loom hours and the test of enduring benefit cannot help the Revenue." (emphasis supplied)*

31. According to the learned counsel for the Assessee, the expenditure on intangibles/brand, even assuming that it was incurred by the Assessee merely facilitates the Assessee carrying on his business and cannot be said to be any enduring nature so as to say that the expenditure in question was capital expenditure.

32. The learned counsel for the Assessee also placed reliance on the decision of the Hon'ble Supreme Court in the case of SA Builders Vs. CIT 288 ITR 1(SC) wherein the Hon'ble Supreme Court was dealing with a case of disallowance of interest paid on loans borrowed which were given to the sister concern without charging interest. The Hon'ble Supreme Court held that the High Court and other authorities should have enquired as to whether the interest-free loan was given to the sister company (which is a subsidiary of the assessee) as a measure of commercial expediency, and if it was, it should have been allowed. The

expression "commercial expediency" is an expression of wide import and includes such expenditure as a prudent businessman incurs for the purpose of business. The expenditure may not have been incurred under any legal obligation, but yet it is allowable as a business expenditure if it was incurred on grounds of commercial expediency. What is commercial expediency in a given facts and circumstances of a case is the sole discretion of the Assessee and not of the revenue authorities.

33. The next submission of the learned counsel for the Assessee was that there was no acquisition of any intangibles nor was there any outflow towards acquiring intangibles. The revenue authorities have presumed that the Assessee has incurred expenditure when there is no basis for coming to such conclusion. To say that an expenditure has been incurred or accrued to an Assessee there should either be an outflow of funds or incurring of a liability. There was no such outflow or accrual of liability during the previous year. It was submitted by him that the fact that the sale price of the Assessee is less than its cost price cannot be the basis to conclude that any expenditure was incurred by the Assessee.

34. On the question whether there was any acquisition of intangibles at all by the Assessee, the learned counsel for the Assessee submitted that the Assessee has not recognised the existence of any such goodwill or any other intangibles or brand. Our attention was drawn to the following passage of the Hon'ble Supreme Court in the case of CIT Vs. B.C.Srinivasa Setty 128 ITR 294 (SC):

> *"A variety of elements goes into its making, and its composition varies in different trades and in different businesses in the same trade, and while one element may preponderate in one business, another may dominate in another business. And yet, because of its intangible nature, it remains insubstantial in form and nebulous in character. Those features prompted Lord Macnaghten to remark in IRC vs. Muller & Co.'s Margarine Ltd. (1901) AC 217 (HL), that although goodwill was easy to describe, it was none the less difficult to define. In a progressing business goodwill tends to show progressive increase. And in a failing business it may begin to wane.*

Its value may fluctuate from one moment to another depending on changes in the reputation of the business. It is affected by everything relating to the business, the personality and business rectitude of the owners, the nature and character of the business, its name and reputation, its location, its impact on the contemporary market, the prevailing socio-economic ecology, introduction to old customers and agreed absence of competition. There can be no account in value of the factors producing it. It is also impossible to predicate the moment of its birth. It comes silently into the world, unheralded and unproclaimed and its impact may not be visibly felt for an undefined period. Imperceptible at birth it exists enwrapped in a concept, growing or fluctuating with the numerous imponderables pouring into, and affecting, the business."

35. Our attention was also drawn to a decision of the Hon'ble Bombay High Court in the case of Evans Fraser & Co. Vs. CIT 137 ITR 493(Bom) which again explains the nature of goodwill in the following terms:

"Does this, however, make any difference ? As we have seen earlier, goodwill is a fluctuating thing. It increases and it decreases, but such increase or decrease is not like the periodic waxing and waning of the moon nor is it like the tide which regularly ebbs and flows twice in twenty-four hours. Goodwill built up over the years can be destroyed in a matter of days, if not much less. Goodwill is never constant. Proteus-like it changes constantly, and as goodwill changes from time to time so does its value. It is possible to ascertain the value of goodwill at a particular point of time, and the modes of calculating such value can easily be found in any standard book on accountancy. Our attention has been drawn to several of them. It is, however, needless to burden the judgment with reference to any one of them. That, however, is not decisive of the matter. Merely because goodwill of a business which had been started by someone else had been acquired, and at the time of acquisition its value ascertained, it does not mean that some time or some years later the goodwill enjoyed by that business in the hands of the purchaser is qualitatively the same goodwill which had been enjoyed at the moment of sale by the vendor. If at the subsequent point of time the value of the goodwill had changed, it would be because the goodwill enjoyed by that business had changed qualitatively. Goodwill differs from a tangible asset such as an immovable property or a share in a joint stock company which retains its shape and form but of which the market value fluctuates. The market value of goodwill also fluctuates, but it fluctuates because of the fluid nature of goodwill. ***Just as it is impossible to pinpoint when goodwill came into existence, so it is equally impossible to pinpoint the moment at which goodwill waxed or increased or it waned or decreased, for, the***

process is imperceptible; and just as in the case of a newly started business it is not possible to ascertain in terms of money the cost of acquisition of goodwill; it is equally impossible to ascertain in terms of money the cost of addition or alteration to the quality of goodwill which led to the increase in its value. *It, therefore, makes no difference whether starting from scratch a business builds up a goodwill of say Rs. 1,00,000 or starting with an acquisition of goodwill of a business for a sum of Rs. 1,00,000 the business so purchased builds up a goodwill of Rs. 5,00,000. Neither the sum of Rs. 1,00,000 in the first case nor the addition of Rs. 4,00,000 in the second case can be taken either as fluctuation in the market value of goodwill, with the goodwill remaining constant, or as the cost of improving or adding to the quality of the goodwill. Such increase is really due to the fact that by further selfgeneration the goodwill has increased. The argument of Mr. Joshi, that the ratio of the Supreme Court decision in the case of B. C. Srinivasa Setty (supra) applies only where there is no cost of acquisition is, therefore, not correct and cannot be accepted. In the judgment in that case the Supreme Court referred to the two views which had prevailed until it finally settled the law, the preponderance of judicial opinion being the same as the view taken by the Supreme Court in B. C. Srinivasa Setty's case, the only two High Courts to have taken a contrary view being the Gujarat High Court in CIT vs. Mohanbhai Pamabhai (1973) 91 ITR 393, and the Calcutta High Court in K. N. Daftary vs. CIT 1976 CTR (Cal) 23 : (1977) 106 ITR 998 (Cal). The Supreme Court has also mentioned in its judgment the decisions of High Courts which had earlier taken the same view as the Supreme Court did, and obviously approved of the view expressed by these High Courts. Amongst them is the decision of this High Court in CIT vs. Home Industries & Co. (supra), which has already been referred to by us earlier in another context. In that case, Tulzapurkar, Actg. C.J. (as he then was), speaking for the Court, said as follows (at pp. 6312):*

> *"However, the aspects that in the case of self-created or self-generated goodwill it is impossible to say that it has been acquired at any particular point of time and that the acquisition of such capital assets costs nothing to the owner of business in terms of money seem to us to be a very important aspect which have a bearing on the question as to whether the transfer of such capital asset should give rise to chargeable capital gains or not. Similarly, the aspect that the capital asset in question must be such that it is capable of improvement at an ascertainable cost in terms of money would be equally important". (The emphasis h*as been supplied by us.)"

36. It was submitted by the learned counsel for the Assessee that in the light of the nature of goodwill or intangible/brand as explained above, it is not correct on the part of the AO to conclude that the Assessee incurred expenses towards creating intangibles/brand etc. or to say that the profits foregone by the Assessee was in effect an expenditure incurred for creating intangibles/brand.

37. On the issue of the CIT(A) disallowing depreciation on intangibles in exercise of his powers of enhancement u/s.251(2) of the Act, arguments were sought to be advanced by the learned counsel for the Assessee. The Bench however expressed the view that since there was violation of principles of natural justice, the said issue should at best be restored to the AO, if necessary and required.

38. Arguments were also sought to be raised with regard to the manner of determination of the profit margins that Assessees similarly placed as that of the Assessee would have earned in similar transactions. It was argued that the method adopted by the AO is not recognised by the provisions of the Act and on this score the valuation is liable to be held bad in law. On this issue also, it was opined by the bench that the Assessee has not given its basis of valuation and if necessary and required the objections to the valuation as set out in the various grounds of appeal comprised in Gr.No.5 can be directed to be reconsidered by the AO/CIT(A).

39. The learned DR submitted that the Assessee is a wholesaler. He submitted that a wholesaler buys goods at a price and adds to such price indirect costs and profits and the sale price is determined accordingly. The Assessee in the present case incurs loss at the gross level. According to him such loss at gross level in the case of a wholesaler is exceptional. It can happen only when the wholesaler is dealing in perishable goods and the Assessee admittedly is not dealing in goods of a perishable nature. The Assessee has itself admitted that it incurs loss at the

gross profit level (gross level) only to capture market. The Assessee's personnel admitted in his statement that the Assessee indulges in predatory pricing only to capture market and help its retailers to survive in the recently developing E-Commerce. It was further brought to our notice that over and above the sale price being below its cost of purchase, the Assessee has also offered cash discount at 3% of its sales. These circumstances according to him show that the Assessee's business model is not normal business model. The Assessee by sacrificing its profits by indulging in predatory pricing intends to develop brand for its business and this is a business strategy knowingly employed by the Assessee. The profits foregone to the extent it is below the cost of purchases should be regarded as expenditure incurred for building brand for its business. There is therefore nothing wrong in concluding that the Assessee passively incurred expenditure to build brand for its business.

40. The learned DR with the aforesaid prelude put forth the following propositions:

1. Even assuming that the Assessee's strategy is to capture market share in the long run, how long can it be permitted to indulge in this strategy.
2. Despite making losses, the Assessee's shares are being purchased by investors at a high premium. In this regard two instances of purchase by venture capitalists of the shares of the Assessee of Re.1/- in the previous years relevant to AY 15-16 and 14-15 at a premium of Rs.1899/- and Rs.595/- respectively was brought to our notice. According to him such high share premium is justified only because of the asset base created by the Assessee in the form of brand value. To a query from the Bench as to whether the share valuation in the transactions referred to above were based on any value attached to any intangibles, the learned DR replied that there is no such valuation on record but only can infer from circumstances that value would have been attached to brand/goodwill or other intangibles.
3. He reiterated that the business model of the Assessee by following predatory pricing was to create asset base of customers and build brand value/goodwill or any other form of intangibles. He drew attention of the Bench to the profit and loss account and submitted that the Advertising and Sales

promotion expenses incurred by the Assessee was a paltry sum of Rs.78,79,113/- compared to its huge turnover. That shows that predatory pricing is its main advertising and sales promotion.

4. His next submission was that it sold its web portal "flipkart.com" to M/S.Flipkart Internet (P) Ltd., in previous year relevant to AY 14-15 and even after such sale it continued to indulge in predatory pricing. The benefit of such predatory pricing after such sale benefitted a third party and not the Assessee and therefore even on this basis, the manner of determination of total income of the Assessee as done by the AO is justified.

5. On the argument of the learned counsel for the Assessee regarding methodology of determining income, the learned DR submitted that when predatory pricing methodology is employed to create intangibles for an Assessee there is nothing wrong in treating the profits foregone as an expenditure incurred for creating intangibles and regarding the same as capital expenditure. In this regard it was argued by the learned DR that the tests laid down in the decision of the Hon'ble Supreme Court in the case of Empire Jute case (supra) would be satisfied in the present case. According to him indulging in predatory pricing expands the profit making apparatus and therefore the profits foregone can be regarded as capital expenditure.

41. The learned DR therefore submitted that the approach adopted by the AO was justified in the facts and circumstances of the case and was well within his powers while determining total income under the Act.

42. With regard to the manner of determination of valuation of intangibles and depreciation on intangibles allowed by the AO but withdrawn by the CIT(A), he relied on the orders of the AO and CIT(A) respectively. According to him the manner of determination of value of intangibles as done by the AO was reasonable and has to be upheld.

43. In rejoinder the learned counsel for the Assessee submitted that the AO is not empowered under the Act to tamper with my cost of purchase price when he admits or does not dispute that such price is at market price. Similarly if sale is at a price less than the purchase price, the AO is not empowered under the Act to tamper with the sale price, unless the provisions of Sec.40A(2)(a) is applicable

and admittedly the sale is not to a related party and therefore those provisions or any other provisions of the Act dealing with transactions with related parties are not attracted. He drew our attention to decision of the Hon'ble supreme Court in the case of Vijaya Bank Ltd. Vs. CIT 187 ITR 541(SC). The Assessee in that case purchased securities during the relevant previous year and derived income from such securities. While computing income from securities, the Assessee bifurcated the purchase price it paid for purchasing the securities as comprising of its actual value and interest that had accrued on those securities upto the date of purchase by the Assessee. To the extent the purchase price included interest upto date of purchase the Assessee claimed deduction while computing income from securities contending that it was expenditure incurred to earn income from securities. Such a plea was negative by the Hon'ble Supreme Court and it was held by the Hon'ble Supreme Court in the following words:

> *"It is contended that the price paid for the securities was determined with reference to their actual value as well as the interest which had accrued on them till the date of purchase. But the fact is, whatever was the consideration which prompted the assessee to purchase the securities, the price paid for them was in the nature of a capital outlay, and no part of it can be set off as expenditure against income accruing on those securities. Subsequently when these securities yielded income by way of interest, such income was attracted by s. 18. Claim for deduction can be sustained only when the assessee is in a position to show that any reasonable expenditure had been incurred for the purpose of realising the interest on securities. The amounts claimed by the assessee for deduction are not shown to have been expended for the purpose of realising the interest, and are therefore, not allowable as deductible e*xpenditure."

44. According to him what the revenue has sought to do in the present case by bifurcating the difference between an assumed sale price and the actual sale price and attributing the difference to an expenditure incurred by the Assessee on acquiring intangibles is contrary to the aforesaid ruling of the Hon'ble Supreme Court.

45. On the argument of the learned DR on the cash discounts offered by the Assessee, it was submitted by him that cash discount are revenue expenses and cannot be disallowed. It was submitted by him that predatory pricing is a business strategy and time will tell whether it results in generation of goodwill or brand or any other intangible. If the business model of the Assessee fails where is goodwill or brand or other intangible that has come or will come into existence. Therefore it is premature to say that the Assessee has incurred expenditure to build goodwill or create intangibles or brand.

46. With regard to the contention of the learned DR on sale of shares of the Assessee at a premium, the learned counsel for the Assessee submitted that shares are acquired by the holding company. It is one way of funding subsidiary. Therefore the fact that huge share premium is paid does not in any way help the case of the revenue. Besides the above the transaction of purchase of shares have undergone scrutiny by the Reserve Bank of India and does not in any way have any implications on the case of the revenue in the present appeal.

47. With regard to the argument of the learned DR that the expenditure incurred by the Assessee actually benefited a third party, the learned counsel for the Assessee relied on the decision of the Hon'ble Supreme Court in the case of Sasson David 118 ITR 261(SC). It has been laid down in the aforesaid decision that the expression "wholly and exclusively" used in section 10(2)(xv) of the Indian Income-tax Act, 1922, (corresponding to Sec.37(1) of the Act) does not mean "necessarily". Ordinarily, it is for the assessee to decide whether any expenditure should be incurred in the course of his or its business. Such expenditure may be incurred voluntarily and without any necessity and if it is incurred for promoting the business and to earn profits, the assessee can claim deduction under section 10(2)(xv) of the Act even though there was no compelling necessity to incur such expenditure. The fact that somebody other than the assessee is also benefited by the expenditure should not come in the way of an

expenditure being allowed by way of deduction under section 10(2)(xv) of the Act if it satisfies otherwise the tests laid down by law.

48. On the plea of the learned DR that since the business model of the Assessee is different from the traditional business model, the revenue can resort to a new method of assessment of income, the learned counsel for the Assessee submitted that such new method of assessment should be permissible under the Act and if there is no such provision in the Act permitted a new approach then the AO has no authority to resort to such new method and it is for the legislature to intervene, if it thinks fit. In this regard our attention was drawn to the following decisions:

(i) Union of India Vs. Azadi Bachao Andoloan 263 ITR 706 (SC) wherein it was held 'Treaty shopping' is a graphic expression used to describe the act of a resident of a third country taking advantage of a fiscal treaty between two Contracting States. It is rightly urged by the counsel for the appellants that if it was intended that a national of a third State should be precluded from the benefits of the DTAC, then a suitable term of limitation to that effect should have been incorporated therein. Art. 24 of the Indo-US Treaty on Avoidance of Double Taxation specifically provides the limitations subject to which the benefits under the Treaty can be availed of. One of the limitations is that more than 50 per cent of the. beneficial interest, or in the case of a company more than 50 per cent of the number of shares of each class of the company, be owned directly or indirectly by one or more individual residents of one of the Contracting States. Art. 24 of the Indo-U.S. DTAC is in marked contrast with the Indo-Mauritius DTAC. The appellants rightly contend that in the absence of a limitation clause, such as the one contained in art. 24 of the Indo-U.S. Treaty, there are no disabling or disentitling conditions under the Indo-Mauritius Treaty prohibiting the resident of a third nation from deriving benefits thereunder. They also urge that motives with which the residents have been incorporated in Mauritius are wholly irrelevant and

cannot in anyway affect the legality of the transaction. They urge that there is nothing like equity in a fiscal statute. Either the statute applies proprio vigore or it does not. There is no question of applying a fiscal statute by intendment, if the expressed words do not apply. This contention of the appellants has merit and deserves acceptance. There is no doubt that, where necessary, the Courts are empowered to lift the veil of incorporation while applying the domestic law. In the situation where the terms of the DTAC have been made applicable by reason of s. 90 even if they derogate from the provisions of the IT Act, it is not possible to say that the principle of lifting the veil of incorporation should be applied by the Court. The whole purpose of the DTAC is to ensure that the benefits thereunder are available even if they are inconsistent with the provisions of the Indian IT Act. Therefore, the principle of piercing the veil of incorporation can hardly apply to a situation as the present one. The maxim "Judicis est jus dicere, non dare" pithily expounds the duty of the Court. It is to decide what the law is, and apply it; not to make it. The weighty recommendations of the Working Group on Non-resident Taxation are again about what the law ought to be, and a pointer to the Parliament and the Executive for incorporating suitable limitation provisions in the treaty itself or by domestic legislation. This per se does not render an attempt by resident of a third party to take advantage of the existing provisions of the DTAC illegal. The recommendations of the Working Group of the JPC are intended for Parliament to take appropriate action. The JPC might have noticed certain consequences, intended or unintended, flowing from the DTAC and has made appropriate recommendations. Based on them, it is not possible to say that the DTAC or the impugned circular are contrary to law, nor would it be possible to interfere with either of them on the basis of the report of the JPC.

(ii) DCIT Vs. Baker Hughes Singapore PTE. (2015) 41 ITR (Trib) 0212 (Delhi) (Trib) wherein it was held that Judicial authorities are to interpret the law as it exists and not as it ought to be in the light of certain underlying value notions.

(iii) Maruti Suzuki India Ltd. & another Vs. CIT 381 ITR 117 (Del) wherein it was held if transfer pricing provisions were not applicable to a transaction because of the absence of an international transaction in the matter of incurring of Advertising Marketing and Promotion Expenses (AMP expenses), it was not permissible to invoke chapter X of the Act.

49. As far as the appeal by the revenue is concerned, the issue involved is with regard to quantification of the profit margin of comparable companies chosen by the AO. On the revenue's appeal, the learned DR relied on the order of the AO and pleaded that the computation of expenses on creating intangibles as done by the AO should be restored.

50. We have given a very careful consideration to the rival submissions. As far as the Assessee's appeal is concerned, the issue that arises for consideration is as to whether the determination of total income as done by the AO was justified in the facts and circumstances of the case. The Assessee as we have seen is a wholesale trader. He purchases goods for the purpose of trading at say Rs.100/- from unrelated parties. He sells it to retailers at Rs.80/-. The retailers are also unrelated parties. The retailers sell the goods through the Assessee's web portal "flipkar.com". The trading by the retailers to the end user is through E-Commerce. The customers browse the website and see the various products and place orders electronically. The products are delivered physically to the customers at their desired place. The payment is also made electronically or by cash at the point of deliver to the customers. As far as the Assessee is concerned it deals only with retailers. On sale to the retailers the Assessee incurs loss. The case of the AO is that a wholesale trader normally sells his products at cost + his mark-up (margin) + indirect costs incurred in the business of wholesale trading. The plea of the Assessee is that E-commerce was at a nascent stage and therefore to attract customers to purchase goods through E-Commerce, the only way was to offer goods at a lesser price than what the retailers in physical market in show

room offer (referred to as retailers in brick and mortar). The further plea of the Assessee was that by offering goods at a lesser price, the Assessee in the long run will capture a huge market and generate profits in the long run. According to the AO the strategy of selling goods at lower than cost price was to establish customer goodwill and brand value in the long run and reap benefits in the later years. Therefore the profits foregone in the earlier years by selling goods at less than cost price was to be regarded as expenditure incurred in creating intangibles/brand value or goodwill. Since such expenditure create asset in the form of intangible/brand or goodwill, the expenditure has to be construed as capital expenditure and would go to reduce the loss declared by the Assessee in the return of income. Therefore the loss declared by the Assessee in the return of income filed was converted into positive income by disallowing expenditure. The quantification of expenditure was done by adding to the cost price, profit margin which Assessees engaged in similar business would earn and reducing there from the actual sale value realised by the Assessee. The question is whether the course of action adopted by the AO was permissible under the Act.

51. The relevant statutory provisions of the Act are Section 4 of the Act which creates a charge on the total income of an Assessee and it lays down in Section 4(1) of the Act that where any Central Act enacts that income-tax shall be charged for any assessment year at any rate or rates, income-tax at that rate or those rates shall be charged for that year in accordance with, and subject to the provisions of the Act in respect of the total income of the previous year of every person. Section 5 of the Act lays down the scope of total income under the Act and it lays down that total income of any previous year of a person who is a resident includes all income from whatever source derived which(a) is received or is deemed to be received in India in such year by or on behalf of such person; or(b) accrues or arises or is deemed to accrue or arise to him in India during such year; or(c) accrues or arises to him outside India during such year. Sec.2(24) of the Act defines income by laying down that income includes and lists out several

categories of receipts which can be characterised as income. The definition is inclusive definition and therefore what can be regarded by ordinary connotation of the said term as income can be regarded as income even though they do not fall within any of the categories of income set out in various sub-clauses of Sec.2(24) of the Act. The aspect to be noted is that there should be income and its receipt or accrual because it is only income which accrues or arises that can be subject matter of total income u/s.5 of the Act. Sec.14 lays down that income for the purpose of computation of total income has to be classified under the following heads of income viz., Salaries, Income from house property, Profits and gains of business or profession, Capital gains and Income from other sources. Sec.28 of the Act lays down various categories of income that shall be chargeable to income-tax under the head "Profits and gains of business or profession". The income of the Assessee in the present case would fall within Sec.28(i) of the Act viz., "the profits and gains of any business or profession which was carried on by the assessee at any time during the previous year". Section 145 of the Act provides how income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" has to be computed and it lays down that such income shall, subject to the provisions of sub-section (2), be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee. Sub-section (2) of Section 145 provides that the Central Government may notify in the Official Gazette from time to time *income computation and disclosure standards* to be followed by any class of assessees or in respect of any class of income. Sub-Section (3) of Section 145 provides that Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of accounting provided in sub-section (1) *has not been regularly followed by the assessee, or income has not been computed in accordance with the standards notified under sub-section (2)*, the Assessing Officer may make an assessment in the manner provided in section 144. It is thus clear from the statutory provisions that the starting point of

computing of income from business is the profit or loss as per the profit and loss account of the Assessee. The AO cannot disregard the profit or loss as disclosed in the profit and loss account, unless he invokes the provisions of Sec.145(3) of the Act. In the present case it is not the case of the AO that the provisions of Sec.145(3) of the Act are applicable. In such circumstances, the question is as to whether the AO had power to go beyond the book results. In our view, the AO was not empowered under the Act to do so.

52. As laid down by the Hon'ble Supreme Court in the case of Calcutta Discount Company(supra), when one trader transfers his goods to another trader at a price less than the market price, the taxing authority cannot take into consideration the market price of those goods, ignoring the real price fetched. As laid down by the Hon'ble Supreme Court in the case of A.Raman & Co. (supra), income which has accrued or arisen can only be subject matter of total income and not income which could have been earned but not earned. The decision of the Hon'ble Karnataka High Court in the case of A.Khader Basha (supra) is squarely applicable to the facts of the present case. The facts of the Assessee's case and the facts of the case decided by the Hon'ble Karnataka High Court were identical. The Hon'ble Karnataka High Court held following Hon'ble Supreme Court decision in the case of Calcutta Discount Co. Ltd., reported in 1973(91) ITR 8 (SC) that where a trader transfers his goods to another trader at a price less than the market price and the transaction is a bonafide one, the taxing authority cannot take into account the market price of those goods, ignoring the real price fetched to ascertain the profit from the transaction. The Hon'ble Court explained that the only exception was if Section 40(A)(2)(a) of the Act applies viz., where the parties to the transaction are related. Following the aforesaid decisions, we hold that the AO was not right in proceeding to ignore the books results of the Assessee and resorting to a process of estimating total income of the Assessee in the manner in which he did. We find force in the submission of the learned counsel for the Assessee that what can be taxe is only income that accrues or

arises as laid down in Sec.5 of the Act. Nothing beyond Sec.5 of the Act can be brought to tax. As contended by him there was nothing to show accrual of income so as to disregard the loss declared by the Assessee in the return of income filed. As we have already seen there is no provision in the Act by which the AO can ignore the sale price declared by an Assessee and proceed to enhance the sale price without material before him to show that the Assessee has in fact realized higher sale price. As contended by the learned counsel for the Assessee, wherever the legislature wanted to tax income not earned, it had made specific provisions in the Act by way of deeming fiction like provisions of Sec.43CA(1, Sec.45(4) and Sec.50C(1) of the Act.

53. In view of the above conclusion, there may not be any necessity to deal further with the manner in which the AO has proceeded to compute total income of the Assessee and we can conclude by holding that the loss returned by the Assessee has to be accepted and the manner of determination of total income as done by the AO is not in accordance with law. Nevertheless, we shall also address the issue as to whether the conclusions of the AO that the Assessee incurred expenses in creating intangibles/brand or goodwill and also the question whether the conclusion of the AO that to the extent the Assessee has foregone his profit margin, he can be said to have incurred expenditure in creating intangibles/brand or goodwill.

54. Did the Assessee incur any expenditure as held by the AO in creating intangibles/brand or goodwill? To say that an expenditure has been incurred by an Assessee there should be either accrual of liability or actual outflow in the form of payment. There was no such accrual of liability or actual outflow in the present case. This fact is also acknowledged by the AO. The AO has however proceeded to draw hold that because the Assessee was purchase at Rs.100 and selling the goods to retailers at Rs.80/- the rationale for incurring loss by a wholesale trader at the gross level was very peculiar. Since such a pricing was done keeping in mind

the long run profits of the Assessee which will grow because of the intangible/brand or goodwill which will be generated in the long run. Therefore to the extent profits are foregone by the Assessee, the Assessee can be deemed to have incurred expenditure on creating intangibles/brand or goodwill and such expenditure has to be regarded as capital expenditure and added to the total income of the Assessee.

55. We find no basis for the above conclusions of the AO. The first presumption of the AO is that the Assessee had incurred expenditure. As rightly contended by the learned counsel for the Assessee there was no accrual of any liability on account of any expenditure or actual outflow of funds towards expenditure. One cannot proceed on the basis of presumption that the profit foregone is expenditure incurred and further that expenditure so incurred was for acquiring intangible assets like brand, goodwill etc. As pointed by the Hon'ble Supreme Court and the Hon'ble Bombay High Court in the case of B.C.Srinivasa Setty (supra) and Evans Frazer(supra), for creation of intangibles like say goodwill it is not possible to ascertain in terms of money the cost of acquisition of goodwill; it is equally impossible to ascertain in terms of money the cost of addition or alteration to the quality of goodwill which led to the increase in its value. It is therefore not possible to say that profits foregone created goodwill or any other intangibles or brand to the Assesssee. The argument of the learned DR on the existence of intangibles/brands or goodwill was on the basis of purchase of Assessee's shares at a premium by investors. Despite making losses, the Assessee's shares were purchased by investors at a high premium. In this regard two instances of purchase by venture capitalists of the shares of the Assessee of Re.1/- in the previous years relevant to AY 15-16 and 14-15 at a premium of Rs.1899/- and Rs.595/- respectively was cited by him. According to him such high share premium was justified only because of the asset base created by the Assessee in the form of brand value. This again is an argument without bringing on record any material to substantial that valuation of shares were done only

because of value being ascribed to brand or goodwill or any intangibles. The valuation of shares as per the AO was on DCF method and there is no mention in the order of assessment regarding values being ascribed to goodwill/brand or intangibles. We therefore hold that there was no expenditure incurred by the Assessee except those that are set out in the profit and loss account. The question of incurring expenditure on creating intangibles does not arise for consideration at all.

56. In view of our conclusions that the action of the AO in disregarding the books results cannot be sustained and the further conclusion that the action of the AO in presuming that the Assessee had incurred expenditure for creating intangible assets/brand or goodwill is without any basis, we do not think it necessary to deal with the arguments that even assuming that expenditure was incurred by the Assessee the expenditure for building brand or creating intangible or goodwill is revenue expenditure and allowable as deduction. It is also not necessary for us to go into the question of estimation of quantum of expenditure on creating intangibles, in view of the above conclusions.

57. For the reasons given above, we hold that the loss as declared by the Assessee in the return of income should be accepted by the AO and his action in disallowing expenses and arriving at a positive total income by assuming that there was an expenditure of a capital nature incurred by the Assessee in arriving at a loss as declared in the return of income and further disallowing such expenditure and consequently arriving at a positive total income chargeable to tax is without any basis and not in accordance with law and the said manner of determination of total income is hereby deleted.

58. In the result, appeal by the Assessee is allowed and the appeal by the Revenue is dismissed.

Order pronounced in the open court on **25th April, 2018**.

Sd/-	**Sd/-**
(JASON P.BOAZ)	**(N.V VASUDEVAN)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Bangalore
Dated : 25 /4/2018
Vms

Copy to :1. The Assessee
2. The Revenue
3.The CIT concerned.
4.The CIT(A) concerned.
5.DR
6.GF

By order

Sr. Private Secretary, ITAT, Bangalore