IN THE INCOME TAX APPELLATE TRIBUNAL
"B" BENCH : BANGALORE

BEFORE SHRI A K GARODIA, ACCOUNTANT MEMBER
AND SHRI GEORGE GEORGE K., JUDICIAL MEMBER

| IT(TP)A No.511/Bang/2016 |
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| Assessment year: 2011-12 |

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| The Deputy Commissioner of Income Tax, Circle 5(1)(2), Bangalore. | Vs. | Ocwen Financial Solutions Pvt. Ltd., 6th Floor of Wing A & 5th Floor of Wing B, Block No.12, Pritech Park, Survey No.51064/4, Bellandur Village, Sarjapur Marathahalli Ring Road, Bengaluru – 560 103. **PAN: AAACO 3764E** |
| APPELLANT | | RESPONDENT |

| IT(TP)A No.686/Bang/2016 |
|---|
| Assessment year: 2011-12 |

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|---|---|---|
| Ocwen Financial Solutions Pvt. Ltd., Bengaluru – 560 103. **PAN: AAACO 3764E** | Vs. | The Joint Commissioner of Income Tax, Special Range 5, Bangalore. |

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| Revenue by | : | Shri Muzaffar Hussain, CIT(DR), ITAT, Bengaluru. |
| Respondent by | : | Shri K.R. Vasudevan, Advocate |

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|---|---|---|
| Date of hearing | : | 21.09.2020 |
| Date of Pronouncement | : | 25.09.2020 |

**O R D E R**

*Per George K., Judicial Member*

These are cross appeals against the final order of assessment passed u/s. 143(3) r.w.s. 144C(13) of the Income-tax Act, 1961 [the Act]

pursuant to the DRP's directions dated 21.12.2015. Relevant assessment year is 2011-12.

2. We shall first take up the revenue's appeal in IT(TP)A No.511/Bang/2016. The solitary effective ground raised in revenue's appeal reads as follows:-

> "2. On the facts and in the circumstances of the case, the Ld.DRP erred in law in directing the Assessing Officer to reduce the expenditure incurred in travel, telecommunication etc, both from the Export Turnover as well as the Total Turnover for the purpose of computation of deduction u/s.10A and 10AA of the IT Act without appreciating the fact that the statue allows exclusion of such expenditure only from the Export turnover by way of specific definition of Export Turnover as envisaged by sub-clause(4) of explanation 2 below sub-section 8 of section 10A. On the other hand, there is no specific provision in section 10A or 10AA warranting exclusion of above expenses from total turnover also."

2.1 The AO in his draft assessment order had recalculated the deduction u/s 10A/10AA of the Act by reducing the travelling & conveyance, legal & professional and other expenses incurred in foreign currency from the export turnover.

2.2 The DRP in its order dated 21.12.2015 directed the AO to compute the deduction u/s. 10A of the Act after reducing the impugned expenses both from the export turnover as well as from the total turnover.

2.3 The revenue being aggrieved is in appeal before the Tribunal. The ld. DR supported the draft assessment order passed by the AO.

2.4 The ld. AR submitted that the issue in question is squarely covered by the judgment of the Hon'ble Apex Court in the case of *CIT v. HCL Technologies Ltd. – Civil Appeal Nos. 8489-8490/2013* dated 24.4.2018.

2.5 We have heard the rival submissions and perused the material on record. The issue raised is squarely covered in favour of assessee by the judgment of Hon'ble Apex Court in the case of *CIT v. HCL Technologies Ltd. (supra)*. The Hon'ble Apex Court had categorically held that when expenses are reduced from export turnover, the same needs to be reduced also from the total turnover, while computing deduction u/s. 10A of the Act. The relevant finding of the Hon'ble Apex Court reads as follows:-

> "19. In the instant case, if the deductions on freight, telecommunication and insurance attributable to the delivery of computer software under Section10A of the IT Act are allowed only in Export Turnover but not from the Total Turnover then, it would give rise to inadvertent, unlawful, meaningless and illogical result which would cause grave injustice to the Respondent which could have never been the intention of the legislature.
>
> 20. Even in common parlance, when the object of the formula is to arrive at the profit from export business, expenses excluded from export turnover have to be excluded from total turnover also. Otherwise, any other interpretation makes the formula unworkable and absurd. Hence, we are satisfied that such deduction shall be allowed from the total turnover in same proportion as well.
>
> 21. On the issue of expenses on technical services provided outside, we have to follow the same principle of interpretation as followed in the case of expenses of freight, telecommunication etc., otherwise the formula of calculation would be futile. Hence, in the same way, expenses incurred in foreign exchange for providing the technical services outside shall be allowed to exclude from the total turnover.
>
> 22. In view of above discussion, we are of the considered view that these instant appeals are devoid of merits and deserve to be dismissed. Accordingly, all the connected matters and interlocutory applications, if any, are disposed of with no order as to costs."

2.6 In the light of Hon'ble Apex Court judgment in the case of *CIT v. HCL Technologies Ltd. (supra),* we hold that the DRP is justified in its direction that the impugned expenditure that is reduced from the export turnover need to be reduced also from the total turnover, while computing deduction u/s. 10A of the Act. It is ordered accordingly.

3. In the result, the appeal filed by the revenue is dismissed.

Assessee's appeal (IT(TP)A No. 686/Bang/2016)

4. The assessee in the original grounds had raised TP issues as well as corporate tax issues. The grounds relating to TP issues were with withdrawn since the assessee had received Resolution under the Mutual Agreement Procedure (MAP) and the same was accepted. Consequent to withdrawal of grounds relating to TP issues, the assessee has filed revised grounds and the same reads as follows:-

> "1. Re-computation of deduction under section 10A/10AA - Set off of brought forward losses from the profits of Bangalore unit and Mumbai unit prior to computing deduction under section 10A/10AA
>
> a. The learned Assessing Officer ("AO") and Dispute Resolution Panel ("DRP") has erred in re-computing the deduction under section 10A/10AA of the Act by reducing the brought forward business losses from the profits of business of Mumbai unit and Bangalore unit before computing deduction under section 10A/10AA of the Act.
>
> b. The learned AO and DRP has erred in not placing reliance on various judicial precedents including the jurisdictional High Court ruling in favor of Appellant's contention.
>
> c. The learned AO and DRP erred in observing that jurisdictional High Court ruling is not applicable to the case of the appellant.

d. The learned AO ought to have appreciated that decision of jurisdictional High Court is binding on all Income tax officers (ITO) operating under the jurisdiction of the said High Court.

e. Notwithstanding and without prejudice to the above, the learned AO ought to have reduced the brought forward losses from the transfer pricing adjustment first and then set off the balance, if any, from profits for computing deduction under section 10A/10AA.

2. Disallowance of expenses incurred on buy-back of shares

a. The learned AO and DRP has erred in disallowing expenses incurred on buy-back of shares.

b. The learned AO ought to have observed that no benefit of enduring nature was received by the company from buy back of shares.

c. The learned AO ought to have appreciated that the alleged expenditure is allowable as business expenditure under section 37 of the Act as it satisfies all the prescribed conditions under the said section.

The appellant craves leave to add, alter, vary, omit, substitute or amend the above grounds of appeal, at any time before or at, the time of hearing, of the appeal, so as to enable the Income-tax Appellate Tribunal to decide the appeal according to law.

The appellant prays accordingly."

4. We shall adjudicate the above grounds as under:-

4.1 Set off of brought forward losses: For the AY 2011-12, the assessee had operation in 3 units. 2 units in Bangalore (out of which deduction u/s. 10AA was claimed of one unit) and 1 unit in Mumbai for which deduction u/s. 10A was claimed. The taxable profits for the units for the year under consideration was as under:-

| Particulars | Bangalore Unit (Taxable Unit) | Bangalore Unit (10AA Unit) | Mumbai Unit (10A Unit) | Total |
|---|---|---|---|---|
| Profits and Gains of business before 10A/10AA deduction | 9,18,62,166 | 5,77,47,822 | 2,93,35,804 | 17,89,45,792 |
| Less: Deduction Under section 10A/ 10AA | - | 5,77,47,822 | 2,93,35,804 | 8,70,83,626 |
| Taxable Profits | 9,18,62,166 | - | - | 9,18,62,166 |
| **Less: Set off of brought forward Losses of AY 2005-06, 2006-07 and AY 2010-11** | **1,01,40,720** | | | **1,01,40,720** |
| Taxable business income | 8,17,21,446 | | | 8,17,21,446 |

4.1.1 The AO has reduced the brought forward losses of Rs.1,01,40,720 from Bangalore (10AA unit) and Mumbai (10A unit) before computation of deduction under section 10A/10AA of the Act.

4.1.2 The DRP in its directions affirmed the view of the AO in his draft assessment order. The relevant finding of the DRP reads as follows:-

> "14.2 Thus, the Circular has clarified that the losses, if any, are required to be set-off in respect of the profits of the unit eligible for tax holiday before the deduction under section 10A/10AA/1013/1013A of the Act is allowed. The circular is binding on the AO. So there is no infirmity in the action of the AO. As regards reliance of the Assessee on the decision of Jurisdictional High Court in the case of CIT v Yokogawa India (2012) 341 ITR 385 (Kar), the same is totally misplaced as the said decision was on different facts as the AO had adjusted losses of non eligible units from the profits of the eligible unit. Considering above the objection of the assessee cannot be accepted."

4.1.3 Aggrieved, the assessee is in appeal before the Tribunal. The ld. AR relied on the judgment of the Hon'ble Apex Court in the case of *Yokogawa India Ltd. [2017] 77 taxmann.com 41 (SC)* . The ld. DR supported orders of income-tax authorities and relied on the order of Tribunal in assessee's own case for AY 2006-07 in IT(TP)A No.64/Bang/2011 (order dated 09.10.2015).

4.1.4 We have heard the rival submissions and perused the material on record. The assessee had claimed deduction u/s. 10A/10AA of the Act amounting to Rs.8,70,83,626. The AO in his final assessment order dated 27.1.2016 had recalculated the deduction u/s. 10A/10AA of the Act by reducing brought forward losses amounting to Rs.1,01,40,720 . Accordingly in the final assessment order, deduction was allowed only to the extent of Rs.7,69,42,906. The finding of the AO in this regard reads as follows:-

> "c. Further, it is noticed that the assessee has claimed deductions u/s 10A and 10AA in respect of Bangalore Unit and Mumbai Unit before reducing the C/F losses of earlier years amounting to Rs.1,01,40,720/- . Since as per the provisions of the Act, B/F losses has to be set off first before calculation of deduction u/s.10A/10AA, the loss carried forward is hereby adjusted against the profits of the 10A and 10AA Unit and the deductions are reworked and restricted accordingly."

4.1.5 Further, the conclusion of the AO reads as follows:-

> "Hence, the eligible aggregate deduction u/s.10A Et 10AA is Rs. 7,69,42,906/- as against the claim of Rs.8,70,83,626/-, The excess claim of Rs. 1,01,40,720/- is hereby disallowed and added to the total income."

4.1.6 In this context, the Hon'ble High Court of Karnataka in the case of *Yokogawa India Ltd., 341 ITR 385* has held that income of section 10A unit has to be excluded before arriving at the gross total income of the

assessee. The income of section 10A unit has to be deducted at source itself and not after computing the gross total income. Since the income of section 10A unit has to be excluded at source itself before arriving at the gross total income, it was held by the Hon'ble High Court that the loss of non-section 10A unit cannot be set off against the income of 10A unit under section 72. It was further held by the Hon'ble High Court that when the profits and gains under section 10A is not included in the income of the assessee at all, the question of setting off the loss against such profits and gains of the undertaking would not arise.

4.1.7 The judgment of the Hon'ble High Court of Karnataka was confirmed by the Hon'ble Supreme Court *(supra)*. The order of the Tribunal in assessee's own case, relied on by the ld. DR, is in favour of assessee. The Tribunal distinguished the judgment of the Hon'ble High Court in the case of *CIT v. Himatsingike Seide Ltd. 286 ITR 265* and relied on the Hon'ble High Court judgment in the case of *Yokogawa India Ltd. (supra)* while holding that losses cannot be set off against profits of eligible unit. In view of the judgment of the Hon'ble Apex Court, we direct the AO to calculate the deduction u/s.10A/ 10AA of the Act, without setting off the brought forward losses. It is ordered accordingly.

4.1.8 In the result, ground Nos. 1(a) to 1(d) are allowed.

4.2 <u>Buy-back of shares</u>

4.2.1 During the previous year relevant to assessment year, the assessee had spent a sum of Rs.8,90,961 on buy-back of shares and debited the same to Profit & Loss account. The expenditure was disallowed by the AO in his draft assessment order holding the same to be capital expenditure.

4.2.2 The DRP in its directions confirmed the view of the AO. The relevant finding of the DRP reads as follows:-

> "16.1 The assessee has made submissions on these objections and the same have duly been considered. When a Company buys back shares, it is generally returning the value of the shares in the form of face value as originally paid, accumulated reserves and value of assets like goodwill, etc. that is not recognized in the books. Such return can hardly be treated as business expenditure. The accounting treatment under accounting principles and also under Section 77A (and related provisions) of the Companies Act, 1956, clearly supports this. The face value of shares bought back is reduced from the paid up capital and the surplus (premium) is debited to reserves such as securities premium account or other reserves (other than revaluation reserve). These provisions do not permit debiting the amount paid to profit and loss account for the year. So there is no infirmity in the order of the AO and the objection of the assessee is not accepted."

4.2.3 Aggrieved by the directions of the DRP, the assessee is in appeal before the Tribunal.

4.2.4 The ld. AR submitted that the issue in question is decided in favour of assessee by the judgment of the Hon'ble jurisdictional High Court in the case of *CIT v. Motor Industries Co. Ltd. – ITA No.1064/2008 judgment dated 31.10.2014 (Karnataka High Court).*

4.2.5 The ld. DR supported the orders of income-tax authorities.

4.2.6 We have heard the rival submissions and perused the material on record. The Hon'ble High Court of Karnataka in the case of *CIT v. Motor Industries Co. Ltd. (supra)* has held as follows:-

> "26. The increase in the capital results in expansion of the capital base of the company and incidentally that would help in the business of the company and may also help in the profit-making. The expenses incurred in that connection still retain the

character of a capital expenditure since the expenditure is directly related to the expansion of the capital base of the company. Issue of bonus shares does not result in the expansion of capital base of the company.

It does not lead to any inflow of fresh funds into the company. The capital structure is not expanded. On the contrary the consequence of such buy-back of shares is the capital base of the company gets reduced and the capital structure will go down. It is not of an enduring effect so as to bring the expenditure incurred in this regard as capital expenditure. Where there is no flow of funds or increase in the capital employed, the expenditure incurred would be revenue expenditure. Therefore, rightly the Tribunal held that it is in the nature of revenue expenditure and allowed the same."

4.2.7 In view of the judgment of the Hon'ble High Court of Karnataka in the case of *CIT v. Motor Industries Co. Ltd. (supra)*, we hold that the expenses incurred by the assessee for buy-back of shares amounting to RS.8,90,961 is allowed as a revenue expenditure. It is ordered accordingly.

4.2.8 Therefore, the grounds 2(a) to 2(c) are allowed.

5. In the result, the appeal by the assessee is partly allowed.

6. Thus, the appeal by the revenue is dismissed, while the appeal by the assessee is partly allowed.

Pronounced in the open court on this 25th day of September, 2020.

Sd/- Sd/-

( A K GARODIA ) ( GEORGE GEORGE K )
ACCOUNTANT MEMBER JUDICIAL MEMBER

Bangalore,
Dated, the 25th September, 2020.
*/Desai S Murthy /*

Copy to:

1. Revenue 2. Assessee 3. CIT 4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.