

INCOME TAX APPELLATE TRIBUNAL  
DELHI BENCH "I-2": NEW DELHI  
BEFORE MS SUSHMA CHOWLA, VICE PRESIDENT  
AND  
SHRI PRASHANT MAHARISHI, ACCOUNTANT MEMBER

ITA No. 2160 & 2161/Del/2018  
(Assessment Year: 2004-05 & 2005-06)

Nokia India Pvt. Ltd, TEC, Level 18, DLF Cyber City, Phase- III, Building No. 5, Tower A, Gurgaon PAN: AAACN2170R	Vs.	Addl. CIT, New Delhi
(Appellant)		(Respondent)

Assessee by :	Shri Deepak Chopra, Adv Shri Ankul Goyal, Adv
Revenue by:	Shri Anupam Kant Garg, CIT DR
Date of Hearing	20/08/2020
Date of pronouncement	26/10/2020

ORDER

PER PRASHANT MAHARISHI, A. M.

1. These are 2 appeals filed by the assessee for assessment year 2004 – 05 and 2005 – 06 against the order of the Id CIT (A)-44, New Delhi dated 26.12.2017 for the AY 2004-05 and dated 31<sup>st</sup> of January 2018 for assessment year 2005 – 06. Most of the grounds are common in both these appeals, therefore, they were argued together by the parties and disposed of by this common order.
2. The assessee has raised the following grounds of appeal for AY 2004-05:-
  - “1. *That on the facts and circumstances of the case and in law, the order dated December 26, 2017, passed by the Ld. CIT(A) under Section 250 of the Act, to the extent the additions made by the Ld. AO in the assessment order under Section 143(3) are sustained, is erroneous and bad in law and is liable to be set aside.*
  2. *The Ld. CIT(A) erred on facts and in law in confirming the action of the Ld. AO in disallowing an amount of INR 18,47,08,697 being the provision for warranty. The sub-grounds in this respect are as under:*
    - 2.1. *The Ld. CIT(A) erred on facts and in law in confirming the action of the Ld. AO in disallowing an amount of INR 184,708,697 being the provision for warranty by stating that such provision was contingent in nature.*
    - 2.2. *The Ld. CIT(A) erred on facts and in law in confirming the action of the Ld. AO by not appreciating the fact that the provision for warranty was made by the appellant on a scientific basis*
    - 2.3. *The Ld. CIT(A) has erred in confirming the action of the Ld. AO in disallowing INR 184,708,697 being the provision for warranty by erroneously placing reliance on*

*CIT(A) order of AY 2003-04 instead of order of the High Court for AY 2000-01 and 2001-02 and ITAT in AY 2002-03 in the appellant's own case.*

3. *The Ld. CIT (A) erred on facts and in law in confirming the action of the Ld. AO in disallowing marketing expenditure amounting to INR 65,17,570 (i.e. after allowing depreciation @25% on the total expenses of INR 86,90,093), claimed as revenue expenditure by the appellant in respect of handsets issued on a free of cost ("FOC") basis to employees, dealers and After Marketing Service Centres ("AMSCs"). The sub-grounds in this respect are as under:*
  - 3.1. *The Ld. CIT(A) erred on facts and in law in confirming the action of the Ld. AO in disallowing marketing expenditure amounting to INR 65,17,570, by treating it as capital expenditure in the hands of the appellant.*
  - 3.2. *The Ld. CIT(A) grossly erred on facts and in law in confirming the action of the Ld. AO in disallowing marketing expenditure amounting to INR 65,17,570 by assuming that the ownership of the handsets issued on FOC basis is vested with the appellant and not transferred to the employees, dealers and AMSCs.*
  - 3.3. *Without prejudice to other grounds, the Ld. CIT(A) erred on facts and in law in not allowing depreciation on the closing written down value of FOC handsets, taking into account similar disallowance in earlier assessment years, which would have a consequential impact on the computation of depreciation in the year under consideration.*
4. *The Ld. CIT(A) erred on facts and in law in confirming the action of the Ld. AO in enhancing the value of the closing stock of the appellant by INR 7,69,56,677 [i.e. FOC phones plus damaged handsets of INR 8,56,46,770 after reducing disallowance of INR 86,90,093 on account of marketing expenses as mentioned at ground no. 3 above]. The sub-grounds in this respect are as under:*
  - 4.1. *The Ld. CIT(A) erred on facts and in law in confirming the action of the Ld. AO in enhancing the value of the closing stock of the appellant by INR 7,69,56,677 on the ground that the method of accounting adopted by the appellant company for the valuation of closing stock is wrong and incorrect.*
  - 4.2. *The Ld. CIT(A) erred on facts and in law in confirming the action of the Ld. AO in enhancing the value of the closing stock of the appellant by INR 7,69,56,677 despite the fact that the same were damaged during transit or issued to employees, dealers and AMSCs without any intention to reprocess or resale.*
  - 4.3. *Without prejudice to other grounds, the Ld. CIT(A) erred on facts and in law in not allowing depreciation on the closing written down value of these handsets, that were added to closing stock in the preceding assessment years, which would have a consequential impact on the computation of depreciation for the year under consideration.*
  - 4.4. *The Ld. CIT (A) erred on facts and in law in not providing a deduction of INR 26,817,770, by way of increase in the value of opening stock of AY 2004-05, on account of similar enhancement in the value of closing stock of AY 2003-04 by the AO by INR 26,817,770, despite the fact that similar deduction has been provided by the Ld. AO himself in preceding AY i.e. AY 2003-04.*
5. *The Ld. CIT(A) erred on facts and in law in confirming the action of the Ld. AO in disallowing 25% of the provision for stock obsolescence, amounting to INR 42,80,732, on an ad hoc basis. The sub-grounds in this respect are as under:*

- 5.1. *The Ld. CIT(A) erred on facts and in law in confirming the action of the Ld. AO in disallowing 25% of the provision for stock obsolescence by treating the same as unascertained liability, on an ad hoc basis.*
  - 5.2. *The Ld. CIT(A) erred on facts and in law in confirming the action of the Ld. AO in disallowing 25% of the provision for stock obsolescence disregarding the fact that such provision is made on a scientific basis, in accordance with Global Company Policy of the appellant which is being consistently followed over the years.*
  - 5.3. *The Ld. CIT(A) has erred on facts and in law in ignoring the findings of the DRP in the case of the appellant itself in AYs 2011-12 & 2012-13 and 2013-14 wherein the Hon'ble DRP has deleted the disallowance of 25% of the provision for stock obsolescence.*
  6. *The Ld. CIT(A) erred on facts and in law in the assessment of the arm's length price in relation to the international transaction of contract software development services provided by the appellant.*
  7. *The Ld. CIT(A) erred on facts and in law in confirming the action of the Ld. AO / Ld. TPO in not making an adjustment to account for differences between the risk profile of the appellant, and independent comparable companies, while determining the arm's length price in relation to contract software development services.*
  8. *The Ld. CIT(A) erred on facts and in law in confirming the action of the Ld. AO in reducing the claim of Rs. 16,84,340 made by the appellant under section 80HHE of the Act."*
3. The assessee has raised the following grounds of appeal for AY 2005-06:-
- "1. *That on the facts and circumstances of the case and in law, the order dated January 31, 2018, passed by the Ld. CIT(A) under Section 250 of the Act, to the extent the additions made by the Ld. AO in the assessment order under Section 143(3) are sustained, is erroneous and bad in law and is liable to be set aside.*
  2. *The Ld. CIT (A) erred on facts and in law in confirming the action of the Ld. AO in disallowing the provision for warranty to the extent of INR 320,285,550 . The sub-grounds in this respect are as under:*
    - 2.1. *The Ld. CIT(A) erred on facts and in law in confirming the action of the Ld. AO in disallowing the provision for warranty to the extent of INR 320,285,550, purely based on his surmises and conjectures that provision for warranty, in excess of 10% of actual warranty expenses, is excessive.*
    - 2.2. *The Ld. CIT(A) erred on facts and in law in confirming the action of the Ld. AO by not appreciating the fact that the provision for warranty was made by the appellant on a scientific basis*
    - 2.3. *The Ld. CIT(A) has erred in confirming the action of the Ld. AO in disallowing the provision for warranty to the extent of INR 320,285,550, by erroneously placing reliance on CIT(A) order of AY 2004-05 instead of order of the High Court for AY 2000-01 and 2001-02 and ITAT in AY 2002-03 in the appellant's own case.*
  3. *The Ld. CIT (A) erred on facts and in law in confirming the action of the Ld. AO in disallowing marketing expenditure amounting to INR 35,649,818 (i.e. after allowing depreciation @15% on the total expenses of INR 41,940,962), claimed as revenue expenditure by the appellant in respect of handsets issued on a free of cost ("FOC") basis to employees, dealers and After Marketing Service Centres ("AMSCs") and scrapped handsets. The sub-grounds in this respect are as under:*

- 3.1. *The Ld. CIT(A) erred on facts and in law in confirming the action of the Ld. AO in disallowing marketing expenditure amounting to INR 35,649,818 , by treating it as capital expenditure in the hands of the appellant.*
- 3.2. *The Ld. CIT(A) grossly erred on facts and in law in confirming the action of the Ld. AO in disallowing marketing expenditure amounting to INR 35,649,818 by assuming that the ownership of the handsets issued on FOC basis and scrapped handsets is vested with the appellant and not transferred to the employees, dealers, AMSCs etc.*
- 3.3. *Without prejudice to other grounds, the Ld. CIT(A) erred on facts and in law in not allowing depreciation on the closing written down value of FOC handsets, taking into account similar disallowance in earlier assessment years, which would have a consequential impact on the computation of depreciation in the year under consideration.*
- 3.4. *Without prejudice to the other grounds, the Ld. CIT (A) erred on facts and in law in not providing a deduction of INR 76,956,677, by way of increase in the value of opening stock of AY 2005-06, on account of an enhancement in the value of closing stock of AY 2004-05 by the AO by INR 7,69,56,677, despite the fact that similar deduction has been provided by the Ld. AO himself in the AY 2003-04.*
4. *The Ld. CIT (A) erred on facts and in law in confirming the action of the Ld. AO in disallowing 25% of the provision for stock obsolescence, amounting to INR 6,934,200, on an ad hoc basis.*

*The sub-grounds in this respect are as under:*

- 4.1. *The Ld. CIT(A) erred on facts and in law in confirming the action of the Ld. AO in disallowing 25% of the provision for stock obsolescence by treating the same as unascertained liability, on an ad hoc basis.*
- 4.2. *The Ld. CIT(A) erred on facts and in law in confirming the action of the Ld. AO in disallowing 25% of the provision for stock obsolescence disregarding the fact that such provision is made on a scientific basis, in accordance with Global Company Policy of the appellant which is being consistently followed over the years*
- 4.3. *The Ld. CIT(A) has erred on facts and in law in ignoring the findings of the DRP in the case of the appellant itself in AYs 2011-12 & 2012-13 and 2013-14 wherein the Hon'ble DRP has deleted the disallowance of 25% of the provision for stock obsolescence.*
5. *the Ld. CIT (A) erred on facts and in law in confirming the action of the Ld. AO / Ld. TPO in rejecting certain comparables selected by the appellant, on the basis of incorrect reasons, while determining the arm's length price in relation to contract software development services.*
6. *The Ld. CIT(A) erred on facts and in law in confirming the action of the Ld. AO /Ld. TPO in not making an adjustment to account for differences between the risk profile of the appellant, and independent comparable companies, while determining the arm's length price in relation to contract software development services.*
7. *The above grounds of appeals are independent and without prejudice to one another.*
8. *The appellant craves leave to add / withdraw or amend any ground of appeal at the time of*

4. The facts as called out from assessment year 2004 – 05 shows that assessee is a wholly-owned subsidiary company of Nokia Corporation, Finland, engaged in the business of providing installation/commissioning services and direction of telecommunication equipment, sale of mobile handsets and carrying out the research and development activity through its centers at Hyderabad and Bangalore. It filed its return of income on 1 November 2000 for declaring income of ₹ 81,584,4500/-. Assessment u/s 143 (3) of the income tax act, 1961 was passed by the assessing officer on 19<sup>th</sup> of December 2006 wherein the income of the assessee was assessed at ₹ 1,133,587,905/- wherein following additions/disallowances/adjustments were made:-
- a. foreign travel expenditure disallowed ₹ 6,408,328/-
  - b. disallowance of warranty provisions of ₹ 184,708,697
  - c. disallowance of marketing expenditure of ₹ 6,517,570
  - d. addition on account of valuation of closing stocks 7,69,56,677/-
  - e. disallowance on account of provision for obsolescence of inventory ₹ 4,280,732
  - f. disallowance of excess depreciation on UPS , stabilizer, LAN /Wan ₹ 2,712,668
  - g. addition on account of arm's-length price as per the order of the learned transfer pricing officer ₹ 35,503,033/-
  - h. restriction of deduction u/s 80 HHE claimed by the assessee of ₹ 1,684,314/- to ₹ 1,028,635/-
5. Assessee aggrieved with the order of the learned assessing officer preferred an appeal before the learned CIT – A, who passed an order on 26 December 2017 partly allowing the appeal of the assessee. The assessee aggrieved with that order is contesting following disallowances confirmed by him in appeal before us:-
- a. disallowance of provision for warranty of ₹ 184,708,697/- as per ground number two of the appeal
  - b. disallowance of marketing expenditure of ₹ 6,517,570 as per ground number three of the appeal
  - c. addition on account of the value of closing stock of the appellant by ₹ 76,956,677/- on account of free of cost phones plus damaged handsets of ₹ 8,56,46,770 after reducing the disallowance of ₹ 8,690,093 on account of marketing expenses as per ground number 4
  - d. disallowance of 25% of provision for stock obsolescence amounting to ₹ 4,280,732/- as per ground number five
  - e. confirmation of the addition on account of determination of arm's-length price in relation to the international transactions of contract software development services

provided by the appellant and not granting the adjustment on account of risk profile of the assessee as per ground number 6 and 7

f. the restriction of the deduction claimed by the assessee u/s 80 HHE of the act of ₹ 1,684,340/-

6. Ground number 1 is challenging the overall assessment made by the learned assessing officer and confirmed by the learned CIT – A is general in nature, no specific arguments were raised other than the arguments advanced with respect to the each of the addition confirmed by the learned CIT – A independently in different grounds, therefore same is dismissed. Similarly ground number 9 and 10 of the appeal are also general in nature and hence those are also dismissed.
7. Ground number 2 of the appeal is against the provision for warranty upheld by the learned CIT – A. The learned authorised representative referred to page number 4 – 7 of the assessment order and page number 71 – 72 of the order of the learned CIT – A and submitted that the learned assessing officer and the Commissioner appeals have relied on the orders of the assessment year 2003 – 04 wherein the coordinate bench have decided the issue in favour of the assessee. He further submitted that the order of the coordinate bench has been upheld by the honourable High Court. He further referred to the findings of the honourable High Court on the issue of provisions of the warranty at para number 7 and stated that this issue is squarely covered in favour of the assessee.
8. The learned departmental representative vehemently supported the order of the learned lower authorities.
9. We have carefully considered the rival submission and perused the order of the lower authorities. The fact shows that in schedule 13 to profit and loss account the assessee has claimed warranty expenditure of ₹ 417,694,333/-, assessee also submitted a note for computing book profit Under the minimum alternative tax u/s 115JB with respect to the warranty expenditure stating that provision of the warranty debited in the profit and loss account represents estimated provision on scientific basis in respect of mobile phone handsets. The learned assessing officer after examination of the claim of the assessee and held that the claim of the assessee is not an ascertained liability and same cannot be accepted as the working of the provision for warranty on the amounts set-aside as provision is not clear and not supported by any evidence. He further held that as mobile technology is changing very fast the provision of warranty made by the assessee based on past experience are not relevant. He further held that the new models with the improved technologies will have less failure rates as compared to the order mobile model phones. Therefore he held the warranty provision made by the assessee as a contingent liability and disallowed the same

applying the provisions of Section 37 (1) of the act. The learned and CIT – A confirmed the above disallowance based on his order for assessment year 2003 – 04. Appeals for the assessment year 2003 – 04 in that case troubled to the level of the honourable High Court. In assessee's own case for assessment year 2003 – 04 the issue has been considered by the honourable High Court in PRINCIPLE COMMISSIONER OF INCOME TAX VERSUS NOKIA INDIA (P) LTD (2018) 98 TAXMANN.COM 415 (DELHI) where the revenue challenged the order of the coordinate bench and ground of appeal raised by the revenue was dismissed as Under:-

“6. We have considered the contention but do not find any merit in the same. As stated by the Assessing Officer in the assessment order, the table reveals that there was substantial increase and jump in sales year after year in the Assessment Years 2002-03, 2003-04, 2004-05 and 2005-06, from Rs.58.97 crores to Rs.830.51 crores to Rs.2408.01 crores, and then to Rs.4729.14 crores, respectively. The provision for warranty would accordingly increase in numerical terms. Pertinently, the percentage of closing provision of warranty with reference to quantum of sales had decreased and came down as is reflected in the figure in the column (h) of the table above. In the present case, we are only concerned with the Assessment Year 2003-04 in which the percentage of closing provision to sales was only 0.81%. Variation in figure would indicate that no thumb rule was applied. Moreover in case of doubt and debate, Income Tax Authorities should have asked for the basis and the formula/criteria applied by the respondent/assessee to compute provision for warranty. On the other hand without disputing the computation, disallowance was made by holding that actual expenditure on warranty claims and not provision for warranty was allowable as expenditure. This proposition is wrong and incorrect. Improvement in technology would not justify disallowance of claim/expenditure on account of provision for warranty, though in a given case on basis of data it could be relevant factor in making the calculations.

7. In the aforesaid factual matrix and in view of the decision of the Supreme Court in *Rotork Controls India (P.) Ltd.'s case (supra)* and decision of this Court in respondent-assessee's case in ITA Nos.841/2009 and 842/2009, we do not find any good ground or reason to accept the aforesaid contention of the Revenue.”

The learned departmental representative could not show us any reason or change in the facts and circumstances of the case compared to the facts in the case of the assessee for assessment year 2003 – 04 wherein the honourable High Court has dismissed the appeal of the revenue on this count. Therefore, respectfully following the decision of the honourable High Court in assessee's own case for assessment year 2003 – 04, we allow ground number 2 of the appeal of the assessee for assessment year 2004 – 05.

10. As both the parties before us that ground number 2 of the appeal of the assessee for assessment year 2005 – 06 in ITA number 2161/del/2018 also involves the same ground except the change in the amount where identical facts and circumstances exist. Therefore we also allow ground number two of the appeal for assessment year 2005 – 06.
11. With respect to ground number 3 of the appeal, the learned authorised representative submitted that ground number 3 of the appeal of the assessee for assessment year 2004 – 05 and 2005 – 06 is identical except the change in the amount. Facts as stated in the assessment order for assessment year 2004 – 05 in para number 5 shows that assessee has debited marketing expenditure of ₹ 441,511,916/- of marketing expenditure which includes cost of mobile handsets issued free of cost to after marketing services centers, dealers and employees amounting to ₹ 8,690,093/-. The learned assessing officer questioned the assessee that why the above amount should not be disallowed being capital expenditure in nature. Assessee gave a detailed explanation stating the purpose of giving such phones to the employees and dealers and other service partners and stated that above expenditure is allowable as a revenue expenditure incurred wholly and exclusively for the purposes of the business u/s 37 (1) of the income tax act. The learned assessing officer held that those handsets are not part of the trading activities of the assessee company and their ownership remains with the assessee. He further held that these handsets have not been shown as purchases by the assessee in the profit and loss account but has been debited and the head marketing expenses. Therefore he was of the view that these expenditure cannot be allowed to the assessee revenue expenditure and remains as capital assets in the hands of the assessee and therefore he allowed depreciation at the rate of 25%. Therefore he made the net disallowance of ₹ 6,517,570. The issue reached the learned CIT – A, he confirmed the disallowance following his own order for assessment year 2003 – 04 holding that handsets which are damaged during the transit and those issued to the employees/dealers and AMSC did not qualify as stock of the appellant were in the nature of the capital assets on which depreciation was to be allowed u/s 32 (1) of the act.
12. The learned authorised representative submitted that for assessment year 2003 – zero for the identical issue has been decided by the honourable Delhi High Court in assessee's own case wherein the claim of the assessee allowed by the coordinate bench has been upheld. He further stated that identical ground is ground number 3 for assessment year 2005 – 06.
13. The learned departmental representative supported the orders of the lower authorities.
14. We have carefully considered the rival contentions and perused the orders of the lower authorities. On examination of the issue before the lower authorities it is apparent that identical issue has been entered by the coordinate bench in assessee's own case for

assessment year 2003 –04 , wherein claim of the assessee was allowed and the issue reached to the doorstep of the honourable High Court and order of the coordinate bench was confirmed. The honourable High Court PRINCIPLE COMMISSIONER OF INCOME TAX VERSUS NOKIA INDIA (P) LTD (2018) 98 TAXMANN.COM 415 (DELHI) held that:-

“8. Second issue raised by the Revenue relates to capitalization of marketing expenses to the extent of Rs.39.98 lakhs. Assessing Officer had observed that the respondent-assessee had provided mobile handsets to their dealers, employees and after-sale-service centres. He held that these mobile handsets should be considered as capital assets used by the respondent-assessee for its business and accordingly the respondent-assessee was entitled to claim depreciation on these mobile handsets. This addition was upheld by the Commissioner of Income Tax (Appeals) holding his predecessors in the Assessment Years 2000-01, 2001-02 and 2002-03 had upheld the said decision, though appeals were pending before the Tribunal.

9. The Tribunal in the impugned order has held that the respondent-assessee was engaged in the manufacture, import and sale of mobile handsets. They had a large number employees, a wide team of dealers and sales personnel. The respondent-assessee had transferred title or ownership of the mobile handsets to the employees, dealers, sales personnel etc., who were given mobile handsets free of cost and were no longer owned by the respondent-assessee. These mobile phones were not to be returned to the respondent-assessee. Accordingly, the cost of the mobile phones was business expenditure and was rightly reduced from the inventory. Thus, the respondent-assessee was justified in treating these mobile phones as expenditure incurred. The amount cannot be capitalized.

10. The aforesaid finding regarding capitalization or business expenditure is a finding of fact. Obviously, respondent-assessee could not have claimed title and depreciation, once the mobile phones etc. had been given and ownership had been transferred to the employees, dealers, sales personnel and after-sales-service centres. In the absence of any material and evidence to show that the findings of fact are perverse, we do not see any reason to interfere with the impugned order on the said aspect.”

The learned departmental representative could not show us any reason or change in the facts and circumstances of the case. Therefore, respectfully following the decision of the coordinate bench which is been upheld by the honourable High Court on the identical circumstances and facts of the case, we allow ground number 3 for assessment year 2004 – 05 and assessment year 2005 – 06 wherein the marketing expenses on free of cost phones issued to the employees as well as the service centre dealers claimed by the assessee as revenue expenditure, disallowed by the AO holding it to be capital expenditure, direct the learned assessing officer to delete the disallowance of the whole expenditure and also Simultaneously to withdraw grant of 25% depreciation thereof.

15. Ground number 4 of the appeal of the assessee for assessment year 2004 – 05 is with respect to the addition on account of closing stock of free of cost phones of ₹ 76,956,677/-. The brief

fact shows that the closing stock of the assessee has been computed after excluding free issue of phones of 15,554 numbers. The assessee was asked to furnish the details of mobile phones issued free of cost to employees and others and value adjusted from closing stock and show cause as to why the same should not be added to the closing stock of the assessee. The assessee submitted that same has been incurred as revenue expenditure and therefore same cannot be now considered in the closing stock. The learned assessing officer held that ₹ 85,646,770 was reduced on account of free of cost handset issued including damages from the closing stock. According to the AO it cannot be written off in the books of accounts but required to be included in the closing stock inventory of the assessee. Therefore he rejected the method of the assessee of reducing the closing stock with reference to the value of free handset issued and reduced out of trading stock before sales. Identical issue arose in the case of the assessee for assessment year 2003 – 04. The impact for the same during the year was only ₹ 76,956,677 being (₹ 8,56,46,717 - ₹ 8,690,093/–) was disallowed. On appeal before the learned and CIT – A same was confirmed following the order of the first appellate authority for assessment year 2003 – 04.

16. The learned authorised representative submitted that this issue has been considered by the coordinate bench in assessee's own case for assessment year 2003 – 04 wherein the addition/disallowance was deleted. He further stated that revenue challenged the same before the honourable High Court against the order of the coordinate bench and the honourable High Court dismissed the appeal of the revenue. Therefore the issue stands covered in favour of the assessee by the decision of the coordinate bench which is confirmed by the honourable High Court for assessment year 2003 – 04.
17. The learned departmental representative supported the order of the learned assessing officer.
18. We have carefully considered the rival contention and perused the orders of the lower authorities. For assessment year 2003 – 04 for the identical issue reached the coordinate bench wherein per order dated 30.01.2018 in ITA 2445/Del/2010 had decided the issues in favour of the assessee. However, the Hon'ble High Court, when the order of the coordinate bench was challenge by the revenue in order dated 31.08.2018 in ITA No. 955/2018 had remanded the said issue back to this Tribunal. In the remand back proceedings vide its order dated 08.07.2019 the coordinate bench has decided the issue in favour of the Assessee. The coordinate bench followed the orders of the earlier years wherein it has been held that since the value of goods damaged/lost during transit is miniscule in comparison to the total turnover (0.31% in the subject year), such loss is not an unusual loss. Also, the adjustment shall be revenue neutral as the increase in closing stock shall consequently increase the value of opening stock of the following year. Therefore, respectfully following the decision of the

coordinate bench in assessee's own case for earlier years, where revenue could not show any change in the facts and circumstances of the case of the minuscule amount in comparison to the total turnover of disputed stock, we allow ground number 4 of the appeal of the assessee and direct the learned assessing officer to delete the addition on account of inclusion of closing stock of free of cost phones issued.

19. The ground number 5 of the appeal for assessment year 2004 – 05 and ground number 4 of the appeal for assessment year 2005 – 06 is also on identical facts with respect to the addition on account of provision for obsolescence of inventory. The learned assessing officer noted that schedule 13 to the profit and loss account the assessee has debited and amount of Rs 1,71,22,928/- as provision for obsolescence of inventory. The learned assessing officer proposed that why 25% of such obsolescence loss debited should not be disallowed. The learned assessing officer noted that in assessee's own case for assessment year 2001 – 02 the learned CIT – A has allowed 75% of the total provision for obsolescence of inventory being likely to become obsolete and confirmed the balance addition of 25%. The revenue has accepted the decision of the CIT – A and no further appeal before the coordinate bench was recommended on this ground. He held that since the facts and circumstances of the case for the year Under consideration are similar, 25% of the total provision for obsolescence of inventory claimed of Rs 1 71,22,926/- a sum of ₹ 4,280,732 is disallowed. The matter reached the learned CIT – A confirmed the same.
20. The learned authorised representative submitted that that both the learned assessing officer as well as the learned CIT – A have relied on the orders for assessment year 2003 – 04 wherein upon remand back by the coordinate bench, the learned dispute resolution panel wide order dated 3 April 2019 has decided the issue in favour of the assessee. He therefore submitted that when the DRP has deleted the addition for assessment year 2003 – 04 for both these years also the identical disallowance as it is covered in favour of the assessee may be deleted.
21. The learned departmental representative vehemently supported the orders of the lower authorities. We have carefully considered the rival contention and perused the order of the learned assessing officer as well as the learned CIT – A for assessment year 2004 – 05 as well as for assessment year 2005 – 06 where this ground has been raised by the assessee as per ground number 5 and ground number 4 respectively for both the years. The parties before us have confirmed that there is no change in the facts and circumstances of the case in both the years. We find that the learned Dispute Resolution Panel in the set-aside proceedings before the learned assessing officer as per its order for AY 2003-04 in para number 2.1.2 has held as under:-

“2.1.2 from the AO’s order we find that they were not given any finding on the submissions of the assessee before him, particularly basis of creation of the provision of obsolescence, of allowability of the provision for tax purposes even though the narrative part of the assessee submissions have been quoted by him in the order at paragraph number 6.4. We have considered the submissions of the assessee; on similar facts the DRP directed deletion of similar addition in case of the assessee for assessment years 2011 – 12, 2012 – 13 and 2013 – 14. Following the same facts being the same, the AO is directed to delete the addition.”

As in the current year also the learned assessing officer has not done any exercise on his part, the disallowance proposed by the AO constantly being deleted by the learned dispute resolution panel in subsequent years also, we allow ground number 5 of the appeal for assessment year 2004 – 05 and ground number 4 for assessment year 2005 – 06 direct the learned assessing officer to delete the disallowance of 25% of the provision for obsolescence of inventory for both the years.

22. The ground number 6 and 7 of the appeal for assessment year 2004 – 05 and ground number 5 and 6 for AY 2005-06 are related to the transfer pricing adjustments which are not pressed by the learned authorised representative as submitted in his chart of the issues, those grounds are dismissed as not pressed.
23. The ground number 8 of the appeal is with respect to the non consideration of the foreign exchange gain while computing the deduction u/s 80 HHE of the income tax act.
24. The learned authorised representative submitted that this issue is squarely covered in favour of the assessee by decision of the Honourable Karnataka High Court In CIT Versus Infosys Technologies Ltd (2012) 349 ITR 606 and CIT Versus Novel Software Development Private Limited (2013) 355 ITR 339. The issue is also been decided in favour of the assessee by the coordinate bench in Sujata Grover V DCIT (2002) 74 TTJ 347 Delhi.
25. The learned departmental representative vehemently supported the order of the learned assessing officer.
26. We have carefully considered the rival submission as well as the order of the lower authorities. During the year the assessee has claimed deduction on export of computer software u/s 80 HHE of the income tax act amounting to ₹ 1,684,340/- the claim of the assessee was supported with report of an auditor in form number 10 CCAF. The AO notice that assessee has not reduced 90% of the other income amounting to ₹ 374,211,748 for the purpose of working of total profit of the business for the purpose of computing the above deduction. The assessee submitted the various details and thereafter the learned assessing officer noted that against the export turnover of ₹ 17.74 crores the assessee has shown

foreign exchange gain of ₹ 34.28 crores which cannot be on account of foreign exchange gain on export turnover/sales for the assessment year Under consideration and therefore he held that it cannot be treated as income derived from export of software outside India. Therefore according to him 90% of the foreign exchange gain is required to be adjusted. Therefore according to him the deduction u/s 80 HHC of the act is to be allowed after deduction of 90% of the other income of ₹ 374,211,448/-. Thus he computed the deduction u/s 80 HHE of ₹ 1,028,635/- accordingly the disallowance of deduction of ₹ 655,705/- was made against the claim of the assessee of ₹ 1,684,340 which is allowed by AO of only ₹ 1,028,635/-. The matter reached the learned CIT – A wherein as per ground number 9 assessee challenged the above adjustment, which is been dealt with in his order) number 6.23 – 6.25, wherein the learned CIT appeal has not followed the decision of the coordinate bench in case of Sujatha Grover (Supra) holding that same is rendered in the context of Section 80 HHC of the income tax act. Now the issue squarely covered in favour of the assessee by the decision of the honourable Karnataka High Court in Commissioner of Income-tax, Central Circle v. Novell Software Development (I) (P.) Lt [2013] 35 taxmann.com 414 (Karnataka)/[2013] 219 Taxman 32 (Karnataka)(MAG.)/[2013] 355 ITR 339 (Karnataka)/[2013] 260 CTR 372 (Karnataka) wherein it has been held as Under:-

“11. Appearing on behalf of revenue, the submission of Sri Aravind, learned standing counsel is that with reference to Section 80HHC(i) now read as Section 80HHC(iv), the assessee is entitled for the benefit of Section 80HHE deduction from the gains that is derived by the assessee from the business of export activity; that the gains attributable to fluctuation in foreign exchange rate is not precisely derived from the export business but because of the fortuitous circumstance of the exchange rate being not the same throughout and the word 'derived' having come in for interpretation and noticed by the Supreme Court in the case of *Liberty India Ltd. v. CIT* [2009] 317 ITR 218/183 Taxman 349 and following its earlier view taken in *CIT v. Sterling Foods* [1999] 237 ITR 579/104 Taxman 204 and having held that the profit should be directly' attributable to the export activity and in the instant case it having been attributed directly to the fluctuation in the exchange rate, the assessee could not have got the benefit and the Tribunal is in error in answering this issue against the revenue and in favour of the assessee.

12. The distinction made between the words 'derived from' and 'attributable to' is emphasised to submit derived from is a narrow word and therefore, ought to be strictly construed as such.

13. On the second question he submits that the issue is now covered in favour of the revenue and against the assessee in view of the judgment of this Court in the case of *J.K. Industries Ltd. v. Asstt. CIT* [2013] 351 ITR 434/214 Taxman 52/31 taxmann.com 389 where the words 'total income' had been understood as total income as arrived at after providing for unabsorbed depreciation and unabsorbed losses of the earlier years and therefore after

arriving at the total income, allowing the deduction to be made there from out of the total income is erroneous.

14. On the other hand, appearing on behalf of the respondent/assessee, Mr Surayanarayana - learned counsel submits that the second question is no doubt covered against the assessee but not by this judgment but the later judgment of this Court in the case of *J.K. Industries Ltd. v. Jt. CIT* [2013] 351 ITR 454 and though it was a case rendered in the context of the benefits to be claimed under Section 80HHC, the ratio is equally applicable to the deduction that can be claimed under Section 80HHE of the Act and in terms of the answer to a similar question posed for determination, the question had been answered in favour of the revenue and therefore, the question may be answered in favour of the revenue.

15. However, with regard to the first question regarding the amount attributable to the fluctuation in the foreign exchange rate, Mr Suryanarayana would submit that this amount is not the amount which can be said to be derived from the second degree source as pointed out in the very judgment of the Supreme Court in the case of *Liberty India Ltd. (supra)*, in particular paragraph 14, which is also read upon by the learned counsel for the revenue that as far as the present appeal is concerned, the only activity of the assessee is to produce software and export and assessee has no other business activity or profits and the fluctuation in exchange rate is an incidental aspect but it is the entire amount that is received inclusive of difference attributable to the fluctuation in the foreign exchange rate that is treated as the value of the exports and therefore, no distinction can be made as between the actual value of the export of the goods and the amount attributable to the gains from fluctuation of the foreign exchange rates etc.

16. In view of the submissions at the bar, we have examined the questions. The amount which is sought to be attributed as gain from fluctuation of foreign exchange no-doubt might have been due to some fluctuation but as these are amounts received in Indian currency as the total amount that an exporter receives ultimately for the export of the goods,- it should be taken together with the value of the goods itself in which event, in our opinion, even the amount said to be attributable to the fluctuation in the foreign-exchange rate forms part of the value of the export goods and cannot be distinguished there from. In fact the converse of this viz., if the fluctuation in foreign exchange brought down the value, an assessee cannot claim that this amount should be excluded and the export value maintained at a higher figure.

17. Though it may be an aspect beyond the control of the assessee or the revenue, it does affect the actual value of the exported goods either way. We are of the opinion that the tribunal has not committed any error on this aspect. Therefore, there is no occasion to exclude 90% of the amount attributable to export gains from the foreign exchange rate fluctuation and accordingly, we answer the first question against the revenue and in favour of the assessee.”

27. Therefore, respectfully following the decision of the honourable Karnataka High Court, we also hold that 90% of the foreign-exchange gain cannot be reduced from the profits and gains of the business of the export of software while calculating deduction u/s 80 HHE of the income tax act. Accordingly ground number 8 of the appeal for assessment year 2004 – 05 filed by the assessee is allowed.

28. Ground number 9 and 10 for assessment year 2004 – 05 and ground number 7 and 8 for assessment year 2005 – 06 are general grounds in the nature, no separate submissions are made by both the parties therefore, those are dismissed.
29. In the result, appeal of the assessee for assessment year 2004 – 05 and 2005 – 06 are partly allowed.

Order pronounced in the open court on 26/10/2020.

-Sd/-  
(SUSHMA CHOWLA)  
VICE PRESIDENT

-Sd/-  
(PRASHANT MAHARISHI)  
ACCOUNTANT MEMBER

Dated: 20/10/2020  
A K Keot

Copy forwarded to

1. Applicant
2. Respondent
3. CIT
4. CIT (A)
5. DR:ITAT

ASSISTANT REGISTRAR  
ITAT, New Delhi