

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'I-1', NEW DELHI**

Before Sh. Kul Bharat, Judicial Member

Dr. B. R. R. Kumar, Accountant Member

(Through Video Conferencing)

ITA No. 466/Del/2021 : Asstt. Year : 2016-17

Avaya India Pvt. Ltd., 202, Platina, 2 nd Floor, Plot No. C-59, G-Block, Bandra Kurla Complex, Bandra(E), Mumabi, Maharashtra-400051	Vs	ACIT, Circle-1(1), New Delhi
(APPELLANT)		(RESPONDENT)
PAN No. AAECA3592N		

Assessee by : Sh. Kamal Sawhney, Adv.

Revenue by : Sh. Surender Pal, CIT DR

Date of Hearing: 05.07.2021

Date of Pronouncement: 09.07.2021

ORDER

Per Dr. B. R. R. Kumar, Accountant Member:

The present appeal has been filed by the assessee against the order passed by the AO u/s 143(3) r.w.s. 144C(13).

2. Following grounds have been raised by the assessee:

"1. That, the final assessment order framed by National e-Assessment Centre, Delhi (hereinafter referred to as "the Ld. AO") pursuant to the directions of the Hon'ble Dispute Resolution Panel - I (hereinafter referred to as "the Hon'ble DRP") under section 143(3) read with section 144C(13) and read with sections 143(3A) & 143(3B) of the Income-tax Act, 1961 ("the Act"), is a vitiated order having been passed in violation of principles of natural justice and is otherwise arbitrary and is thus bad in law and is void ab-initio.

TP adjustment in relation to notional interest on overdue receivables [INR 5.92.86.7971]

2. That on the fact of the case and in law, the Ld. AO/ TPO /Hon'ble DRP have erred, in making an adjustment of INR 5,92,86,797 to the total income of the Appellant in respect of notional interest on overdue receivables.

2.1 That on the facts of the case and in law, the Ld. AO/ TPO/ Hon'ble DRP have erred in making the said adjustment despite Appellant being a debt free company and no TP adjustment can be made for overdue receivables as upheld in Appellant's ITAT case for AY 2014-15 (ITA No. 7290/Del/2018) and AY 2015-16 (ITA No. 9131/Del/2019).

2.2 That on the facts of the case and in law, the Ld. TPO/ Hon'ble DRP have erred in re-characterizing the inter-company receivables as a separate international transaction of an unsecured loan and imputing interest on such transaction.

2.3 That on the facts of the case and in law, the Ld. TPO/ Hon'ble DRP have erred in not appreciating that inter-company receivables arising out of provision of services by the Appellant to its AE is closely linked to such transaction and no separate TP adjustment is warranted.

2.4 That on the facts of the case and in law, the Ld. TPO/ Hon'ble DRP have erred in not appreciating the fact that the Appellant has provided services to non-AEs wherein no interest is charged on overdue receivable by the Appellant.

2.5 That on the facts of the case and in law, the Ld. TPO/Hon'ble DRP have erred in determining the arm's length interest rate for inter-company receivables at LIBOR plus 400 basis points on an arbitrary basis without any cogent reasons.

2.6 That on the facts of the case and in law, the Ld. TPO/Hon'ble DRP have erred in granting the credit of

period of 60 days instead of 90 days having regard to the provisions of Section 92CE of the Act.

2.7 That on the facts of the case and in law, the Ld. TPO/Hon'ble DRP have erred, by not appreciating that Appellant has earned more than arm's length return in its other segments, and such excess remuneration should be "set off" with the proposed adjustment.

TP adjustment in relation to marketing support services [INR 2,82.89.2601]

3. That on the fact of the case and in law, the Ld. AO/ TPO / Hon'ble DRP has erred by not accepting the economic analysis undertaken by the Appellant in accordance with the provisions of the Act read with the Income Tax Rules, 1962 ('the Rules'), and conducting a fresh economic analysis for the determination of the ALP of the Appellant's international transaction pertaining to provision of marketing support services and holding that the said international transaction is not at an arm's length without sharing the detailed accept reject matrix for selection or rejection of companies evaluated by him.

3.1 That on the facts of the case and in law, the Ld. TPO / Hon'ble DRP have erred, in law and on facts and circumstances of the case, by wrongfully rejecting comparable companies and including certain non-comparable companies to the final set of comparable companies for the purpose of determining the ALP of the subject international transaction on an ad-hoc basis, thereby resorting to cherry picking of comparable companies.

3.1.1 That on the facts of the case and in law, the Ld. TPO/ Hon'ble DRP, erred in selecting Interactive Manpower Solution Private Limited ("Interactive Manpower") as comparable company by erroneously contending that Interactive Manpower is functionally comparable to the Company.

3.1.2 That on the facts of the case and in law, the Ld. TPO, erred in rejecting the additional companies

identified by the Appellant namely Cameo Corporate Services Limited and Murugappa Management Services Limited as comparable to the Appellant without giving any cogent reasons.

Corporate tax grounds:

Addition on account of difference in the income offered to tax by the Appellant in the return of income vis-a-vis Form 26AS statement [INR 1,47,84,0841]

4.1 That on the facts and circumstances of the case and in law, the Ld. AO has passed a non-speaking order and proceeded, to make addition of INR 1,47,84,084 without giving any detailed reasons for making addition of INR 1,47,84,084 as unexplained income taxable under section 68 of the Act read with section 115BBE(1) of the Act to the income of the Appellant.

4.2 That on the facts and circumstances of the case and in law, the Ld. AO has erred in invoking the provisions of section 68 read with section 115BBE of the Act without appreciating the fact that there is no unexplained credit in the books of account of the Appellant for the subject AY and thus, addition made by the Ld. AO is bad in law and is liable to be deleted.

4.3 That on the facts and circumstances of the case and in law, the Ld. AO has erred in making addition amounting to INR 1,47,84,084 on account of difference in the income credited to profit and loss account and offered to tax by the Appellant in its return of income filed for AY 2016-17 vis-a-vis the amount appearing in the Form 26AS statement for AY 2016-17.

4.4 That on the facts and circumstances of the case and in law, the Ld. AO has erred in making addition of INR 1,47,84,084 merely on the basis of information available in Form 26AS statement for the subject AY without appreciating the fact that the same does not represent income earned by the Appellant for subject AY.

4.5 That on the facts and circumstances of the case and in law, the Ld. AO has erred in not following the directions of the Hon'ble DRP, wherein the Hon'ble DRP has directed the Ld. AO to verify the details and delete the addition.

Incorrect computation of interest under section 234B of the Act

5. That on the facts and circumstances of the case and in law, the Ld. AO has erred in charging interest under section 234B of the Act.

Deduction of Education cess and Secondary Higher Education cess ('Cess')

6. That on the facts and in the circumstances of the case, the Ld. AO/Hon'ble DRP has erred in not allowing the deduction of the liability for Education cess and Secondary Higher Education cess ('Cess') on income-tax levied for AY 2016-17 under the head income from business and profession.

TP adjustment in relation to software services [INR NIL]

The below grounds are without prejudice to the fact that TP adjustment in relation to software services was deleted by Ld. AO/Ld. TPO while giving effect to Hon'ble DRP directions.

7. That on the fact of the case and in law, the Ld. AO/ TPO / Hon'ble DRP has erred by not accepting the economic analysis undertaken by the Appellant in accordance with the provisions of the Act read with the Rules, and conducting a fresh economic analysis for the determination of the ALP of the Appellant's international transaction pertaining to provision of software services and holding that the said international transaction is not at an arm's length without sharing the detailed accept reject matrix for selection or rejection of companies evaluated by him.

7.1 That on the facts of the case and in law, the Ld. TPO / Hon'ble DRP have erred, in law and on facts and circumstances of the case, by wrongfully rejecting comparable companies and including certain non-comparable companies to the final set of comparable companies for the purpose of determining the ALP of the subject international transaction on an ad-hoc basis, thereby resorting to cherry picking of comparable companies.

7.1.1 That on the facts of the case and in law, the Ld. TPO/ Hon'ble DRP, erred in selecting Cigniti Technologies Limited, Tata Elxsi Limited, RS Software (India) Limited, Acewin Agriteck Limited, Megri Soft Limited, Cybage Software Private Limited and Cybercom Datamatics Information Solutions Limited as comparable companies by erroneously contending that these companies render software services.

7.1.2 That on the facts of the case and in law, the Ld. TPO, in particular, erred in rejecting the additional companies identified by the Appellant namely Sagar Soft (India) Limited, Kals Information Systems Limited, Sankhya Infotech Limited, Isummation Technologies Private Limited, Maveric Systems Limited and Infomile Technologies Limited as comparable to the Appellant without giving any cogent reasons.

TP adjustment in relation to IT enabled services
[INR NIL]

The below grounds are without prejudice to the fact that TP adjustment in relation to IT enabled services ("ITeS") was deleted by Ld. AO/Ld. TPO while giving effect to Hon'ble DRP directions,

8. That on the fact of the case and in law, the Ld. AO/ TPO / Hon'ble DRP has erred by not accepting the economic analysis undertaken by the Appellant in accordance with the provisions of the Act read with the Rules, and conducting a fresh economic analysis for the determination of the ALP of the Appellant's international transaction pertaining to provision of ITeS by the

Appellant and holding that the said international transaction is not at an arm's length without sharing the detailed accept reject matrix for selection or rejection of companies evaluated by him.

8.1 That on the facts of the case and in law, the Ld. TPO / Hon'ble DRP have erred, in law and on facts and circumstances of the case, by wrongfully rejecting comparable companies and including certain non-comparable companies to the final set of comparable companies for the purpose of determining the ALP of the impugned international transactions on an ad- hoc basis, thereby resorting to cherry picking of comparable companies.

8.1.1 That on the facts of the case and in law, the Ld. TPO/ Hon'ble DRP, in particular, erred in selecting Mindtree Limited, Newgen Software Technologies Limited, Datamatics Business Solutions Limited, Nihilent Analytics Limited and ABM Knowledgeware Limited as comparable companies by erroneously contending these companies renders ITeS.

8.1.2 That on the facts of the case and in law, the Ld. TPO, in particular erred in rejected Informed Technologies India Limited ("Informed Technologies") by incorrectly holding that Informed Technologies does not pass the service income filter applied by Ld. TPO despite the fact that Informed Technologies actually passes the service income applied by learned TPO of "reject companies whose revenues from services is less than 75% of total operating revenues".

8.1.3 That on the facts of the case and in law, the Ld. TPO, in particular, erred in rejecting the additional companies identified by the Appellant namely Sundaram Business Services Limited, Crystal Hues Limited, Suprawin Technologies Limited, Jindal Intellicom Private Limited, ISN Global Solutions Private Limited and ACE Software Exports Ltd as comparable to the Appellant without giving any cogent reasons.

Other Grounds

9. *That on the facts of the case and in law, the Ld. TPO/ Hon'ble DRP have erred, in law and on facts and circumstances of the case, by selecting companies which are earning supernormal profits as compared to the Appellant.*

10. *That on the facts of the case and in law, the Ld. TPO / Hon'ble DRP have erred, in law and on facts and circumstances of the case, by treating foreign exchange gain/ loss as non-operating item while determining the ALP of the international transactions.*

11. *That on the facts of the case and in law, the Hon'ble DRP has erred, in law and on facts and circumstances of the case, by considering provision for doubtful debts and provision written back as non-operating items while computing the operating margins of the Appellant and comparable companies.*

12. *That on the fact of the case and in law, the Ld. TPO / Hon'ble DRP has erred in not allowing a risk adjustment to the Appellant on account of the fact that the Appellant is a captive service provider for its associated enterprises and is remunerated on a cost plus basis irrespective of the outcome of the services provided and hence undertakes no market risk, service liability risk, credit and collection risk as against comparable companies that are the full- fledged risk taking entrepreneurs.*

Initiation of penalty proceedings

13. *That on the facts and circumstances of the case and in law, the Ld. AO has erred in initiating penalty proceedings under section 271(1)(c) of the Act."*

Dispute of Comparable:

3. The dispute with regard to the Transfer Pricing Adjustment relates to the selection of one comparable namely, Interactive Man Power Solution Pvt. Ltd. (IMSPL).

4. The assessee is an Indian company incorporated in the year 2000 which is engaged primarily in software programming and applications developers providing services on behalf of and to Avaya US and other Avaya Group entities. The assessee provides support for switching integration and PBX system and specifically deals with IBR, call centre and CMS technology. The assessee also provides marketing support to it's AE which includes advertising, promotion support and back office support

5. The comparable in dispute is engaged in the business of recruitment service provider and staffing solutions. The Id. DRP accepted to the fact that it is clear from the annual report that the comparable in question is engaged in the business of recruitment process outsourcing services but at the same time upheld the action of the TPO holding that the comparable is providing support services to their clients. We have seen that there are no segmental financials for marketing and the functions of the assessee are different from that of the comparable thus defaulting the FAR analysis. Hence, we hereby direct that IMSPL be deleted from the list of comparables.

6. The grounds taken up at 3.1.2 is not pressed.

Transfer Pricing Adjustment - Notional Interest:

7. The other dispute with regard to the Transfer Pricing Adjustment relates to notional interest on receivables.

8. The TPO after examination of the balance sheet found that the assessee has not received the payments for the invoices raised by the assessee within the stipulated time as provided in the service agreement with the AE's. The TPO held that the delayed payments are being treated as unsecured loans advanced to the AE and charged interest @ 12.51% (6 months LIBOR plus 400 basic point for computing notional interest) for the delayed period. The Id. DRP held that the TPO action cannot be faulted with relying on the judgment of Hon'ble Delhi High Court in the case of CIT Vs Cotton Naturals India Pvt. Ltd. 55 Taxman 401 and the order of the ITAT in BECHTEL India Pvt. Ltd. Vs ACOT 84 Taxman 121 for the assessment year 2012-13.

9. Before us, the Id. AR argued that re-characterizing the overdue receivables as unsecured loans extended by the assessee to its AE is an erroneous belief which cannot be held to be correct. He relied on the orders of the Tribunal in assessee's own case for the assessment years 2014-15 and 2015-16.

10. In all these years, the assessee is found to be a debt free company and there is no dispute on these facts. We have considered the judgment of Pr. CIT Vs BECHTEL India Pvt. Ltd. for the assessment year 2010-11 vide order dated 21.07.2016. The Hon'ble High Court after examining the order in the assessee's own case affirmed that when the assessee is a debt

free company, the question of charging any interest on receivables do not arise. The SLP filed by the revenue has been summarily dismissed by the Hon'ble Supreme Court in CC No. 4956/2017. Even on general fundamentals, when the assessee is having their own funds and not paying interest on any loans, then there is no obligation on the assessee to charge interest from the interest free loan given nor any provision of the Act mandate the Assessing Officer to add notional interest received to the total income. Hence, keeping in view the entire factum of the case, the assessee being a debt free company, the action of the revenue making adjustment on account of notional interest on the receivables cannot be held to be legally valid.

TDS & AS-26:

11. This ground relates to reconciliation of income credited to P&L account and in the amount reflected in AS-26. The Id. DRP held that the reconciliation is primary correct and directed the AO to verify and give effect which the AO failed to carry out. The AO is hereby directed to follow the directions given by the Id. DRP without fail while passing the order giving effect to the ITAT order.

Deduction of Education Cess:

12. This ground relates to deduction of "Education Cess" under the head "income from business and profession".

13. The claim of the assessee of deduction of education cess has not been allowed by the Id. DRP. The rationale of the Id. DRP is as under:

"3.11 Ground no 15 relates to the deduction in respect of education cess. This is an additional ground filed, vide letter dated 17.8.2020, under Rule 7(4) of Income Tax (Dispute Resolution Panel) Rules 2009 and which reads as follows:

"The assessee prays that the liability for education cess on income-tax paid for the year ought to be allowed under section 37 of the Income-tax Act, 1961 as a deduction while computing the total income."

Reliance has been placed in this regard on the' decisions of the Hon'ble Bombay High Court in Sesa Goa Ltd v JCIT (117 taxmann.com 96) and the Hon'ble Rajasthan High Court in Chambal Fertilizers and Chemicals Ltd v JCIT (102 CCH 202).

3.11.1 The Panel has very carefully considered the argument and gone through the Sesa Goa and Chambal Fertilizers decisions cited supra. It is noticed that in both the cases, the Hon'ble High Courts have examined the question whether 'cess' is included in section 40(a)(ii) of the Income Tax Act 1961 and having answered this question in negative, both the Hon'ble Courts have assumed that since it is not included in section 40(a)(ii), it becomes allowable u/s 37(1) of the Act. They did not examine the allowability of education cess in terms of the requirements of section 37(1) at all. For instance, the Hon'ble Rajasthan High Court in Chambal Fertilizers was examining the following question of law:

"3. Whether under the facts and circumstances of the case the Ld. ITAT has not erred in holding that the education cess is a disallowable expenditure u/s 40(a)(ii) of the Act?"

Likewise, the Hon'ble Bombay High Court in Sesa Goa framed this question in the following terms:

"17. Therefore, the question which arises for determination is whether the expression "any rate or tax levied" as it appears in Section 40(a)(ii) of the IT Act includes "cess". The Appellant - Assessee contends that the expression does not include "cess" and therefore, tire amounts paid towards "cess" are liable to be deducted in computing the income chargeable under the head "profits and gains of business or profession ".

From the above, it is dearly discernible that the High Courts did not adjudicate on the allowability of education cess u/s 37(1) and merely proceeded on the assumption that it was allowable if it was not hit by section 40(a)(ii).

3.11.2 However, when one looks at the scheme of the Act and examines the interplay of the provisions of section 40(a)(ii) and section 37(1), it becomes clear that in the scheme of the interplay of the twin provisions, it is the allowability of an expenditure or an item or a claim, which has to be first examined u/s 37(1) and only if the said expenditure, item or claim is found to pass muster u/s 37(1), then a further examination is to be necessarily made whether the said expenditure, item or claim is hit by the embargo placed in section 40(a)(ii) of the Act. This is clearly evident from section 40(a)(ii) which starts with a non-obstante clause, which reads as follows:

"40. Notwithstanding anything to the contrary in sections 30 to 38, the following amounts shall not be deducted in computing

the income chargeable under the head "Profits and gains of business or profession", —

(a) in the case of any assessee—

.....

(ii) any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains."

3.11.2.1 The effect of this non-obstante clause in section 4.0 is that the allowability of a deduction u/s 40(a)(ii) shall be barred, if it is otherwise allowable under any of the provision contained in sections 30 to 38. A fortiori, if it does not pass the criteria of allowability u/s 30 to 38 at the threshold, that is the end of the matter and there is no need to go back to section 40(a)(ii).

3.11.2.2 In that view of the matter, the allowability of education cess shall have to be examined first under the terms of section 37(1) i.e. whether the said expenditure has been 'laid out or expended wholly and exclusively for the purposes of business or profession'. The fundamental question, therefore, which arises for consideration is whether education cess is an expenditure 'laid out or expended wholly and exclusively for the purposes of business or profession'. The answer to this question is clearly in negative because 'education cess' is not expenditure at all. Rather, it is a charge upon the profits, similar to income tax. Any expenditure to earn a profit cannot be a part of the profit itself. It is an application of an income

and not an expenditure 'laid out or expended wholly and exclusively for the purposes of business or profession' so as to pass the tests envisaged u/s 37(1). This principle was enunciated by the House of Lords in Ashton Gas Company v Attorney General and Others (1906) AC 10 (HL). The following observation of Earl of Halsbury is illuminating in this regard:

"Profit is a plain English word; that is what is charged with income-tax. But if you confound what is the necessary expenditure to earn that profit with the income-tax, which is a part of the profit itself, one can understand how you get into the confusion which has induced the learned counsel at such very considerable length to point out that this is not a charge upon the profits at all. The answer is that it is. The income-tax is a charge upon the profits; the thing which is taxed is the profit that is made, and you must ascertain what is the profit that is made before you deduct the tax - you have no right to deduct the income-tax before you ascertain what the profit is. I cannot understand how you can make the income-tax part of the expenditure."

This view of the House of Lords was noted with approval by the Hon'ble Supreme Court in CIT v Oriental Fire and General Insurance Co. Ltd. [2007] 161 Taxman 181 (SC).

3.11.2.3 The Ashton Gas decision was followed by Hon'ble Gujarat High Court in S.L.M. Maneklal Industries Ltd. v CIT [1988] 39 Taxman 42 (Gujarat), wherein the question arose whether surtax was an expenditure 'laid out or expended wholly and exclusively for the purposes of business or profession' u/s 37(1). Answering in negative, the Hon'ble Court held thus:

8. A contention similar to the one, raised in the instant case, came up for consideration in the case of *Ashton Gas Co. v. Attorney General* [1906] AC 10 (HL). That was a case in which it was statutorily provided that the profits of Ashton Gas Co. to be divided amongst the shareholders in any year should not exceed the rate of 10 per cent per annum on the ordinary share capital. The company distributed 10 per cent as dividend tax-free. It was urged on behalf of the company that the income-tax was a charge on the profits before distribution to the shareholders which had to be deducted before arriving at the profits and calculating the dividend. It was urged that the tax was charged upon the company and the company was entitled to adopt principle on which it had acted. Buckley, J adjudged and declared that the profits ought to be calculated as inclusive and not exclusive of the amount payable for the year in respect of the income-tax on the profits proposed to be divided. This decision was affirmed by the Court of Appeal. On further appeal to the House of Lords, Earl of Halsbury, L.C. observed as follows:

'Profit is a plain English word; that is what is charged with income-tax. But if you confound what is the necessary expenditure to earn that profit with the income-tax, which is a part of the profit itself, one can understand how you get into the conclusion which has induced the learned counsel at such very considerable length to point out that this is not a charge upon the profits at all. The answer is that it is. The income-tax is a charge upon the profits; the thing which is taxed is the profit made before you deduct the tax— you have no right to deduct the income-tax before you ascertain what the profit is. I

cannot understand how you can make the income-tax part of the expenditure. I share Buckley, J.'s difficulty in understanding how so plain a matter has been discussed in all the Courts at such extravagant length.'

As pointed out above, in the instant case, what is being charged is the total income of the assessee after making adjustments as provided in the Act. It is the profit which the assessee has made which is being taxed.

10. Applying the ratio of the decision of the Supreme Court, surtax cannot be said to be an expenditure incurred wholly and exclusively for the purpose of the business of the assessee. Payment of surtax had nothing to do with the conduct of the business of the assessee. It was not an expenditure incurred for the purpose of business or for the purpose of earning profit. It is only after the profit or income is earned that, as pointed out above, the question of payment of surtax would arise. It is an event which takes place after the income is earned and not in the course of or in the process of earning income. It is out of the profits or income earned that surtax is to be paid. In other words, payment of surtax is application of the profits after they are earned. As discussed above, surtax is levied on excess chargeable profits computed in the manner laid down in the Act. It is a levy on the total income computed under the Act after it is adjusted in accordance with the First Schedule to the Act. Computation of income for the purpose of the Act has to precede the assessment of surtax under the Act. Unless and until computation of total income under the Act is made, the question of chargeable profits and levy of surtax under the Act

does not arise. Admittedly, income-tax is not an admissible deduction for the purpose of computing profits and gains or the total income under the Act. In our opinion, surtax stands on the same footing as income-tax inasmuch as it is also a tax on the total income computed under the Act after its adjustment under the Act. Payment of both income-tax and surtax is application of income after it is earned and not an expenditure incurred for the purpose of business. It is not a deduction before one arrives at the profits inasmuch as it is not payment for the purpose of earning profit. We are, therefore, unable to accept the assessee's contention that payment of surtax is an expenditure laid out wholly and exclusively for the purpose of business and, therefore, allow able deduction under section 37.

*11. Since payment of surtax is not allowable deduction under section 37, the question whether it comes within the mischief of section 40(s)(ii) does not arise. In other words, it is not necessary to consider whether the prohibition contained in section 40(a)(ii) is applicable to the payment of surtax. The view similar to the one taken by us has been taken by the Calcutta High Court in *Molins of India Ltd. v. CIT* [1983] 144 ITR 317, the Karnataka High Court in *CIT v. International Instruments (P.) Ltd.* [1983] 144 ITR 936, Full Bench of the Kerala High Court in *A. V. Thomas & Co. Ltd. v. CIT* [1986] 159 ITR 431 and Madras High Court in *Sundaram Industries Ltd. v. CIT* [1986] 159 ITR 646. In the view which we are taking, we answer the question referred to us in the affirmative and against the assessee."*

3.11.2.4 Thus, 'education cess' fails the test of deductibility at the first stage itself-i.e. under the terms of section 37(1) and, therefore, there is no further need to examine the embargo u/s 40(a)(ii). This aspect of law was not noticed in Sesa Goa and Chambal Fertilizers and the Hon'ble High Courts simply assumed the allowability of 'education cess' as an expenditure 'laid out or expended wholly and exclusively for the purposes of business or profession' u/s 37(1) and just proceeded to examine the prohibition contained in section 40(a)(ii).

3.11.3 That brings us to section 40(a)(ii) and even if one were to assume the deductibility of 'education cess' u/s 37(1) of the Act, the question arises whether the bar contained in section 40(a)(ii) operates qua 'education cess'. To put it simply, the real question would be to see whether 'education cess' is tax so as to fall within the mischief of section 40(a)(ii).

3.11.3.1 It may be noticed at the outset that education cess was introduced as an additional surcharge as explained in the Explanatory Memorandum to Finance Bill 2012. The relevant excerpt from the said Memorandum reads as follows:

"(2) Education Cess — For assessment year 2012-13, additional surcharge called the "Education Cess on income-tax" and "Secondary and Higher Education Cess on income-tax" shall continue to be levied at the rate of two per cent, and one per cent, respectively, on the amount of tax computed, inclusive of surcharge, in all cases. No marginal relief shall be available in respect of such Cess."

An 'additional surcharge' is, therefore, nothing but 'tax', as held by a three-judge Bench the Hon'ble Supreme Court in CIT vs. K Srinivasan [1972] 83ITR 346 (SC). The following words of Grover, J elucidate the law in unequivocal terms:

*"In our judgment it is unnecessary to express any opinion in the matter because the essential point for determination is whether surcharge is an additional mode or rate for charging income tax. The meaning of the word "surcharge" as given in the Webster's New International Dictionary includes among others "to charge (one) too much or in addition." also "additional tax". Thus, the meaning of surcharge is to charge in addition or to subject to an additional or extra charge. If that meaning is applied to section 2 of the Finance Act 1963 it would lead to the result that income tax and super tax were to be charged in four different ways or at four different rates which may be described as (i) the basic charge or rate (In part I of the First Schedule); (ii) Sur- charge; (iii) special surcharge and (iv) additional surcharge calculated in the manner provided in the Schedule. **Read in this way the additional charges form a part of the income tax and super tax.**"*

This judgment in K Srinivasan cited supra, however, was not considered by their lordships of the Bombay High Court and the Rajasthan High Court in Sesa Goa and Chambal Fertilizers cited supra.

3.11.3.2 The Ld. AR of the assessee laid a great deal of emphasis on the Select Committee Report on Income Tax Bill 1961 dated 10th August 1961 and the subsequent circular of the CBDT F. No. 91/58/66-ITJ(19), dated 18th May, 1967), relied

upon by the Hon'ble High Courts in Sesa Goa and Chambal Fertilizers.

3.11.3.2.1 In this regard, it may be appreciated that at the relevant point in time, there was no cess on income-tax under the old Income Tax Act 1922. 'Cess' was levied by different states as 'local levies' under state legislation. The evidence of the same is available through a plethora of cases before various judicial fora at relevant time (as available on various databases). These items of 'cess' were of nominal amount and were sometimes revenue in nature. It was these kinds of 'cess' which was under consideration before the Select Committee on Income Tax Bill 1961, as evident from the minutes of the Select Committee meeting dated 20th June, 1961 (when Shri B.P. Khaitan, speaking for Indian Chamber of Commerce, Calcutta, took up the issue of proposal from Income Tax Bill 1961 on clause 40(a)(ii), which is extracted herein below:

"Shri B. P. Khaitan: Coming to clause 40, item 2 in sub-clause (a) provides that any sum paid on account of any cess, rate or tax, levied as a proportion of the profits, will not be allowed to be deducted in computing business income. I submit that it should be clarified. Take, for instance, the cess on coal. That should be deducted in computing business income.

Shri Morarji Desai: We will consider this."

[See Select Committee on the Income-Tax Bill, 1961: Evidence, p 84 (LS Secretariat, New Delhi, 1961)]

3.11.3.2.2 Accordingly, when the Select Committee deliberated on the proposal, it was concerned with those state levies, which

were either nominal in amount or were sometimes revenue in nature as evident from para 27 of the Select Committee Report dated 10th August, 1961 itself which is reproduced for easy reference:

"27. Clause 40. — The Committee are of the view that all cesses should be allowed as business expenses because they are of small amounts and though sometimes computed on the basis of profits they are really of the nature of revenue expenditure. Therefore, the word "cess" occurring in item (a) (ii) has been omitted.

The Committee further feel that in sub-clause (b) reference to Hindu undivided family, association of persons and body of individuals should be omitted.

The clause has been amended accordingly."

[See Select Committee Report on the Income-Tax Bill, 1961 p ix-x (LS Secretariat, New Delhi, 1961)]

3.11.3.2.3 Thus, the context of the Select Committee Report and the subsequent clarification by the CBDT vide its circular F. No. 91/58/66-1X1(19), dated 18th May, 1967 was the 'cess', levied under state legislation such as coal cess, state duty cess and other cesses levied by the local bodies/states, which is obviously outside the prohibition contained in section 40(a)(ii) of the Act and not the cess on Income Tax which has been introduced as surcharge as clarified in the Explanatory Memorandum to the Finance Bill, 2012. As has been stated in the preceding para, 'education cess' was introduced as an

additional surcharge on income tax, which is income tax only in view of the law laid down by a three-judge Bench of the Hon'ble Supreme Court in K Srinivasan cited supra. The context of the Select Committee Report and the consequent clarification by the CBDT vide its circular F. No. 91/58/66-ITJ(19), dated 18th May, 1967 was, therefore, not considered by their lordships in Sesa Goa and Chambal Fertilizers, cited supra. Thus, there is no doubt that presbyter is only priest writ large, as it is said. Education cess is tax manu brevi.

3.11.3.3 Ld. AR of the assessee took a lot of pains in emphasizing on the Apex Court's holding in Jaipuria Samla Amalgamated Collieries Ltd. [1971] 82 ITR 580 (SC), which also has been referred to in Chambal Fertilizers cited supra to argue that 'profits or gains of any business or profession' has reference only to profits as per section 28 of the Act, and any rate or tax levied upon profits not 'assessed on the basis of profits' should be an allowable expense. Since education cess was not levied upon determined as per section 28 of the Act, is claimed to be an allowable expense.

3.11.3.3.1 The Panel, however, does not find the argument acceptable. It may be noted that Jaipuria Samla was a decision, which followed CIT v Gurupada Dutta (1946] 14 ITR 100 in the context of 'cess' levied under the Bengal Cess Act,1880 and is no longer good law under the Income tax Act 1961 as held by the Supreme Court in Smith Kline & French (India) Ltd. V CIT [1996] 85 Taxman 683 (SC), where BP Jeevan Reddy, J explicated the law in the following terms:

"6. The learned counsel for the appellants placed strong reliance upon the decision of this Court in Jaipuria Samla Amalgamated Collieries Ltd. v. CIT [19711 82 ITR 580 to contend that a tax has to be computed in accordance with the provisions of the Act to fall within the mischief of section 40(a)(ii). In as much as the surtax is computed on a basis different from the basis prescribed in the Act, it is contended, it cannot fall within the four corners of section 40(a)(ii). It is not possible to agree with this contention either. The said decision was rendered with reference to sub-section (4) of section 10 of the Indian Income-tax Act, 1922 which corresponds to sub-clause (n) of clause (a) of section 40 of the present Act. The question therein was whether the amount payable as (i) road and public works cess levied under the Bengal Cess Act, 1880 and (ii) the education cess levied under the Bengal (Rural) Primary Education Act, 1930 falls within the mischief of section 10(4). This Court held that they do not. A perusal of the decision shows that the road and public works cess was levied on immovable property to provide for construction and maintenance of roads and other works of public utility. Under section 5 of the Bengal Cess Act, 1880 all immovable property, with certain exceptions, was subjected to payment of road cess and public works cess. Section 6 of the Bengal Cess Act provided that the said cesses shall be assessed on the annual value of lands and, until provision to the contrary was made by Parliament, on the annual net profits from mines, quarries, tramways, railways and other immovable property at such rates as were to be determined in the manner prescribed. Similarly, the education cess was also levied under section 29 of the Bengal (Rural) Primary Education Act, 1930, on immovable

property on which the road and public works cesses were assessed. The rate at which the education cess was to be levied depended upon the character of the property; in respect of mines and quarries, it was leviable at the rate of three and a half pice on each rupee of annual net profits. It is thus abundantly clear that the levy of aforesaid cesses was upon the immovable properties and not on profits. It is no doubt true that the tax was measured with reference to the net profits of business but it is well-settled by a series of decisions of this Court that the measure by which a tax is computed does not determine the character of the tax vide Union of India v. Bombay Tyre International AIR 1984 SC 420 and Goodricke Tea Co. v. State of West Bengal 1995 (1) Suppl. SCC 707. It is, therefore, idle to contend that the said decision helps the assessee's case in any manner. The cesses considered in the said decision were not taxes 'levied on the profits or gains of any business or profession or assessed at a proportion of or otherwise on the basis of any such profits or gains' within the meaning of section 40(a)(ii) as explained hereinabove. The learned counsel, however, relied upon the following observations in the said decision: "the words 'profits and gains of any business, profession or vocation' which are employed in section 10(4) can, in the context, have reference only to profits or gains as determined under section 10 and cannot cover the net profits or gains arrived at or determined in a manner other than that provided by section 10. The whole purpose of enacting sub-section (4) of section 10 appears to be to exclude from the permissible deductions under clauses (ix) and (xv) of sub-section (2) such cess, rate or tax which is levied on the profits or gains of any business, profession or vocation or is assessed

at a proportion or on the basis of such profits or gains. In other words, sub-section (4) was meant to exclude a tax or a cess or rate the assessment of which would follow the determination or assessment of profits or gains of any business, profession or vocation in accordance with the provisions of section 10 of the Act..... These profits arrived at according to the provisions of the two Cess Acts can by no stretch of reasoning be equated to the profits which are determined under section 10 of the Act. It is not possible to see, therefore, how section 10(4) could be applicable at all in the present case". The learned counsel pointed out that this Court has in the said decision approved the decision of the Privy Council in CIT v Gurupada Dutta [1946] 14 ITR 100 and has further observed that the Parliament must be deemed to have accepted the view taken by the Privy Council by not changing the language of the relevant provision in the Act [section 40(a)(ii)].

7. *We are unable to see as to how these observations help the assessee herein. Firstly, it may be mentioned, section 10(4) of the 1922 Act or section 40(a)(ii) of the present Act do not contain any words indicating that the profits and gains spoken of by them should be determined in accordance with the provisions of the Act. All they say is that it must be a rate or tax levied on the profits and gains of business or profession. The observations relied upon must be read in the said context and not literally or as the provisions in a statute. But so far as the issue herein is concerned, even this literal reading of the said observations does not help the assessee. As we have pointed out hereinabove the surtax is essentially levied on the business profits of the company computed in accordance with*

the provisions of the Act. Merely because certain further deductions [adjustments] are provided by the Surtax Act from the said profits, it cannot be said that the surtax is not levied upon the profits determined or computed in accordance with the provisions of the Act. Section 4 of the Surtax Act read with the definition of 'chargeable profits' and the First Schedule make the position abundantly clear.

8. We may mention that all the High Courts in the country except the Gauhati High Court have taken the view which we have taken herein. Only the Gauhati High Court has taken a contrary view in the decisions in Makum Tea Co. (India) Ltd. v. CIT f19891 178 ITR 453 and Doom Dooma Tea Co. Ltd. v. CIT [1989] 180 ITR 126. The decision of the Gauhati High Court in Makum Tea Co. (India) Ltd.'s case (supra) is under appeal before us in Civil Appeal Nos. 3976-77 of 1995. Similarly, Civil Appeal No. 3246 of 1995 is preferred against the decision of the Gauhati High Court following the decision in Doom Dooma Tea Co. Ltd.'s case (supra). On enquiry, the office has informed that no Special Leave Petition/Civil Appeal has been filed against the decision in Doom Dooma Tea Co. Ltd.'s case (supra). For the aforesaid reasons, we cannot agree with the view taken by the Gauhati High Court in the aforesaid decisions."

3.11.3.3.2 Thus, respectfully following the judgment of the Supreme Court in Smith Kline cited supra, the Panel holds that there is no requirement in section 40(a)(ii) to the effect that for disallowing any rate or tax levied on profits, the said profits and gains should be determined in accordance with the provisions of the Act.

3.11.3.3.3 The Panel accordingly holds that 'education cess' fails the fundamental tests of deductibility u/s 37 and is also hit by the mischief of section 40(a)(ii) of the Income Tax Act, 1961 in view of law laid down in K Srinivasan and Smith Kline cited supra .

3.11.3.4 The assessee's additional ground on this count, therefore, fails and is, accordingly, rejected."

14. Heard the arguments of both the parties and perused the material available on record.

15. The similar issue has been adjudicated by the Co-ordinate Bench of ITAT in a number of cases wherein the "Education Cess" is held to be an allowable deduction. The relevant part of the order depicting the ratio in the case of Bharat Rasayan Ltd. Vs ACIT in ITA No. 1231/Del/2019 vide order dated 02.02.2021 is reproduced hereunder:

"26. Reading the provisions of Section 40(a)(ii), the assessee argued that education cess paid on Income Tax doesn't come under the purview of the definition as it is levied on the amount of Income Tax but not on profits of business. The Id. AR relied on the Circular No. 91/58/66-ITJ(19) by CBDT dated 18.05.1967, which states the effect of the omission of the words 'cess' from Section 40(a)(ii) is that only taxes paid are to be disallowed in the assessment for the assessment years 1962-63 onwards.

27. The Id. AR also relied on the judgment of Hon'ble Rajasthan High Court in the case of Chambal Fertilisers and Chemicals Ltd. Vs JCIT in ITA No. 52/2018 dated 31.07.2018 wherein the same

issue has been decided in favour of the assessee and particularly held that education cess is an allowable expenditure.

28. Further, he argued that in the case of ITC Vs ACIT in ITA No. 685/Kol/2014 dated 27.11.2018 wherein it was held that the education cess is an allowable expenditure.

29. The Id. AR has also relied in the case of Peerless General Finance & Investment Co. Ltd. Vs DCIT in ITA No.937 & 938/Kol/2018 dated 24.03.2019 wherein it was held that education cess is not tax and is an allowable expenditure.

30. The Id. DR argued that it is not the appropriate forum to raise the issue at this juncture. Since, there is no dispute between the assessee and the Assessing Authorities, a non-dispute cannot be adjudicated. He argued that the education cess is a part of the Income Tax and is a charge on the assessee. Hence, it cannot be treated as expense eligible for deduction.

31. Heard the arguments of both the parties and perused the material available on record.

32. Regarding the claim of education cess as an allowable expenditure, we find that the CBDT vide Circular No. 91/58/66 – ITJ(19) clarified as under:

"Interpretation of provisions of Section 40(a)(ii) of the I.T Act – clarification regarding.

Section 40(a)(ii) – Recently a case has come to the notice of the Board where the ITO has disallowed the 'cess' paid by the assessee on the ground that there has been no material change in the provisions of Section 10(4) of the old Act and Section 40(a)(ii) of the new Act.

2. The view of the ITO is not correct. Clause 40(a)(ii) of the IT Bill, 1961 as introduced in the Parliament stood as under:

"(a) any sum paid on account of any cess, rate or tax levied on the profits or gains of any business or profession or assessed at

a proportion of, or otherwise on the basis of, any such profits or gains.”

When the matter came up before the Select Committee, it was decided to omit the word 'cess' from the clause. The effect of the omission of the word 'cess' is that only taxes paid are to be disallowed in the assessments for the years 1962-63 and onwards.

3. The Board desire that the changed position may please be brought to the notice of all the ITOs so that further litigation on this account may be avoided.”

33. The similar issue of allowability of cess u/s 37 has been examined by the Co-ordinate Bench of ITAT in ITA No. 685/Cal./2014 wherein the amount of the cess paid has been held to be an allowable deduction.

34. Further, we find that the Hon'ble High Court of Judicature for Rajasthan at Jaipur in ITA No. 52/2018 in the case of Chambal Fertilizers and Chemicals Ltd. held that in view of the Circular of CBDT where the word 'cess' is deleted, the claim of the assessee for deduction is acceptable. In that case, the Hon'ble High Court held that there is difference between the cess and tax and cess cannot be equated with the cess.

35. We have also gone through the provisions of Sec. 115 of the Income Tax act 1961 which are as under:

"Explanation 2 to section 115JB (2) of the Act defines the term 'Income-tax' in an inclusive manner, which includes cess. Provision of the explanation 2 to section 115JB is as given below:-

For the purposes of clause (a) of Explanation 1, the amount of income-tax shall include—

- (i) any tax on distributed profits under section 115-Q or on distributed income under section 115R;*
- (ii) any interest charged under this Act;*
- (iii) surcharge, if any, as levied by the Central Acts from time to time;*

- (iv) Education Cess on income-tax, if any, as levied by the Central Acts from time to time; and*
- (v) Secondary and Higher Education Cess on income-tax, if any, as levied by the Central Acts from time to time.*

36. Thus, wherever the legislature wanted to include this term specifically in the statute it has done so under the Act. The term 'tax' has been defined in section 2(43) of the Act to include only Income-tax, Super Tax and Fringe Benefit Tax (FBT). Provision of the section 2(43) is as given below:

"tax" in relation to the assessment year commencing on the 1st day of April, 1965, and any subsequent assessment year means income-tax chargeable under the provisions of this Act, and in relation to any other assessment year income-tax and super-tax chargeable under the provisions of this Act prior to the aforesaid date and in relation to the assessment year commencing on the 1st day of April, 2006, and any subsequent assessment year includes the fringe benefit tax payable under section 115WA."

37. Surcharge on income-tax finds place in the First Schedule, but that is not the case so far as Education Cess is concerned. Therefore, the education cess on this reasoning cannot be equated as tax or surcharge. Based on this, it can be said that since the word 'Cess' is not specifically included in the definition, it cannot be considered a part of tax, and accordingly, it should not be disallowed in u/s 40(a)(ii) of the Act.

38. Further, we are guided by the judgment of the Constitutional bench which was also referred in the case of *Dewan Chand Builders & Contractors Vs Union of India & Others in Civil Appeal No. 1830 of 2008 dated 18.11.2011*.

39. The Constitution Bench of this Court in *Hingir Rampur Coal Co. Ltd. Vs. State of Orissa*² was faced with the challenge to the

constitutional validity of the Orissa Mining Areas Development Fund Act, 1952, levying Cess on the petitioner's colliery. The Bench explained different features of a 'tax', a 'fee' and 'cess' in the following passage:

"The neat and terse definition of Tax which has been given by Latham, C.J., in Matthews v. Chicory Marketing Board (1938) 60 C.L.R. 263 is often cited as a classic on this subject. "A Tax", said Latham, C.J., "is a compulsory exaction of money by public authority for public purposes enforceable by law, and is not payment for services rendered". In bringing out the essential features of a tax this definition also assists in distinguishing a tax from a Fee. It is true that between a tax and a fee there is no generic difference. Both are compulsory exactions of money by public authorities; but whereas a tax is imposed for public purposes and is not, and need not, be supported by any consideration of service rendered in return, a fee 1 AIR 1954 SC 282 2 1961 (2) SCR 537 is levied essentially for services rendered and as such there is an element of quid pro quo between the person who pays the fee and the public authority which imposes it. If specific services are rendered to a specific area or to a specific class of persons or trade or business in any local area, and as a condition precedent for the said services or in return for them cess is levied against the said area or the said class of persons or trade or business the cess is distinguishable from a tax and is described as a fee. Tax recovered by public authority invariably goes into the consolidated fund which ultimately is utilised for all public purposes, whereas a cess levied by way of Fee is not intended to be, and does not become, a part of the consolidated fund. It is earmarked and set apart for the purpose of services for which it is levied."

40. We also find that the proceeds from collection of "Education Cess" are not credited to Consolidated Fund but to a non-lapsable Fund for elementary education-"**Prarambik Shiksha Kosh**". Since the proceeds from collection of Education Cess are kept separate for a specified purpose, applying the principles in the aforesaid decision of Apex Court in the case of **M/s Dewan Chand**

Builders (supra), it can be said that the same is not in the nature of tax. Hence, it is allowable as deduction.

41. Further, Provisions of Section 37 are perused which are as under:

"37. (1) Any expenditure (not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession".

Explanation 1.—For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure.

Explanation 2.—For the removal of doubts, it is hereby declared that for the purposes of sub-section (1), any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 (18 of 2013) shall not be deemed to be an expenditure incurred by the assessee for the purposes of the business or profession."

42. From the above, we find that Education Cess is not of the nature described in sections 30 to 36, Education Cess is not in the nature of capital expenditure, Education Cess is not personal expense of the Assessee, it is mandatory for it to pay Education Cess and for the purpose of computation of Education Cess, the Income 'Tax' is taken as the criteria for computational purpose. Thus, the expense of Education Cess is mandatory expenses to be paid but does not fall under capital expense and personal expenditure and hence may be allowed as deduction.

43. We have also gone through the various judgments of judicial authorities pan India wherein the fresh claim of the assessee is considered and the deduction u/s 37 of Education Cess has been allowed. The Hon'ble High Court of Bombay held that the appellate authorities may confirm, reduce, enhance or annul the assessment or remand the case to the AO, because the basic purpose of a tax appeal was to ascertain the correct tax liability in accordance with the law. To mention a few,

- DCIT Vs M/s. Agrawal Coal Corporation Pvt. Ltd ITA Nos. 801 to 803/Indore/2018.
- Atlas Copco India Ltd. Vs ACIT in ITA No. 736/Pune/2011
- Tata Autocomp Hendrickson Vs DCIT in ITA No. 2486/Pune/2017
- Symantec Software India Pvt. Ltd. Vs DCIT in ITA No. 1824/Pune/2018
- Sicpa India Pvt. Ltd. Vs ACIT in ITA No. 704/Kol/2015
- Philips India Ltd. Vs ACIT in ITA No. 2612/Kol/2019
- ITC Limited Vs ACIT in ITA No. 685/Kol/2014
- DCIT Vs The Peerless General Finance & Investment & Co. Ltd. in ITA No. 1469/Kol/2019.
- ACIT Vs ITC Infotech in ITA No. 220/Kol/2017
- Reckitt Benckiser India Pvt. Ltd. Vs DCIT (2020) 117 taxmann.com 519 (Kol.)
- Crystal Crop. Protection Pvt. Ltd. Vs JCIT in ITA No. 1539/Del/2016
- Midland Credit Management India Vs ACIT in ITA No. 3892/Del/2017
- Voltas Ltd. Vs ACIT in ITA No. 6612/Mum/2018
- Sesa Goa Ltd. Vs JCIT (2020) 117 taxmann.com 96 (Bom.)
- Chambal Fertilisers and Chemicals Vs JCIT in ITA No. 52 of 2018 (Raj. HC)

44. Hence, keeping in view the provisions of the Act pertaining to Section 40(a)(ii) and Section 115JB, Circular of the CBDT No. 91/58/66-ITJ(19), the orders of Co-ordinate Benches of ITAT and judicial pronouncements of the Hon'ble High Court of Bombay and Hon'ble High Court of Rajasthan, we

hereby hold that the assessee is eligible to claim the deduction of the 'Education Cess' as per the provisions of Section 37 of the Income Tax Act."

16. Since, the facts and the legal proposition remain same, we hereby allow the appeal of the assessee on this ground.

17. All the grounds argued are hereby adjudicated.

18. In the result, the appeal of the assessee is allowed.

Order Pronounced in the Open Court on 09/07/2021.

Sd/-

(Kul Bharat)
Judicial Member

Dated: 09/07/2021

Subodh

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

Sd/-

(Dr. B. R. R. Kumar)
Accountant Member

ASSISTANT REGISTRAR