

IN THE INCOME TAX APPELLATE TRIBUNAL
“C” BENCH, MUMBAI
BEFORE SHRI BASKARAN BR, ACCOUNTANT MEMBER &
SHRI PAVAN KUMAR GADALE, JUDICIAL MEMBER
ITA No. 1221/Mum/2022
(A.Y: 2015-16)

Procter & Gamble Home Products Pvt Ltd., 495 P&G Plaza, Cardinal Gracias Road, Chakala, Andheri (E), Mumbai- 400099.	Vs.	Pr. CIT – 2 Room No. 344, 3 rd Floor, Aayakar Bhawan, M.K.Road, Mumbai -400020.
PAN/GIR No. : AAACP4072C		
Appellant	..	Respondent

Appellant by :	Mr. Yogesh Thar & Mr. Jishaan Jain.AR
Respondent by :	Mr. Ganesh Bare.DR

Date of Hearing	23.08.2022
Date of Pronouncement	29.08.2022

आदेश / O R D E R

PER PAVAN KUMAR GADALE JM:

The assessee has filed the appeal against the revision order of the Pr.Commissioner of Income Tax(Pr.CIT) -2, Mumbai passed u/s 263 of the Act. The assessee has raised the following grounds of appeal:

GROUND I:

1. On the facts and circumstances of the case and in law, the Principal Commissioner of Income-tax, Mumbai-2 ("the PCIT") erred in invoking provision of Section 263 of the Income-tax Act, 1961 on the alleged ground that the order passed u/s. 143(3) r.w.s. 144C(3) of the Income-tax Act, 1961 is erroneous and prejudicial to the interest of the revenue.

2. The Appellant prays that the action of the PCIT u/s. 263 of the Act be held as void-ab initio or otherwise null and void.

WIHTOUT PREJUDICE TO GROUND I:

GROUND II:

1. On the facts and circumstances of the case and in law, the PCIT erred in directing the Assessing Officer to frame the assessment de novo after conducting requisite enquiry with respect to Appellant's claim of Rs. 277 lakh on account of ESOP and ISOP expenses on the alleged ground that both ESOP and ISOP expenses are capital in nature and that such expenses are neither incurred nor accrued during the relevant year and therefore cannot be considered as deductible expenditure.

2. The Id. PCIT erred in not appreciating that the ESOP and ISOP expenses are actually incurred during the year under consideration, wholly and exclusively for the purpose of the Appellant's business and are thus fully allowable as expense under section 37 of the Act.

3. The Appellant prays that such direction of the PCIT be annulled and it be held that the ESOP and ISOP expenses are deductible expenditure u/s. 37 of the Act

Ground III:

The Appellant craves leave to add to, alter or amend all or any of the above grounds of appeal at the time of hearing.

2. The brief facts of the case are that the assessee company is engaged in the business of manufacture of hair care, skin care, baby care, Hair color, Air freshener and fem care products. The assessee has filed the return of income for the A.Y 2015-16 on 30.11.2015 declaring a total loss of Rs. 42,25,18,790/- and the return of income was processed u/s 143(1) of the Act. Subsequently, the case was selected for scrutiny and notice u/s 143(2) and 142(1) of the Act along with questionnaire are issued. In compliance to the notice, the Ld.AR of the assessee appeared from time to time and furnished the details and the case was discussed. The AO on perusal of the financial statement found that the assessee has international transactions with its Associate Enterprises (A.E) and the matter was referred to the TPO for determination of Arms Length Price(ALP). Whereas the TPO made adjustment in AMP reimbursement with markup, import of raw material, payment for intra group services and receipt of support services and passed the

order u/s 92CA(3) of the Act dated 29.10.2018 with a transfer pricing adjustment of Rs. 176,32,46,524/-. In respect of corporate tax issues (i) the Assessee has credited rental income of Rs.10,42,00,000/- received from M/s. Sigue Support Services Pvt Ltd., M/s. Bibby Ship Management, DSP Merrill Lynch and M/s DHL Logistic. The AO has dealt on the notes of the rental income and the agreement of rental income which is effective from 01.04.2011.

3. The AO find the transactions between the assessee and the parent company are not properly dealt in the financial statements and determined the rental income from house property of Rs. 18,00,04,483/- and disallowed the municipal taxes to the extent of Rs. 36,98,073/- and the depreciation of Rs.1,06,62,874/- on building, repairs and maintenance of building of Rs.1,33,13,130/- and the administration expenses of Rs.17,28,242/- and the draft assessee order u/sec143(3) r.w.s 144C(1) of the Act was passed on 26-12-2017. Whereas, the assessee has filed the objections against the Draft .A. Order with the DRP and were dismissed. Finally the DRP has passed directions u/sec 144C(5) of the Act dated 10-09-2018.

The A.O. in compliance to directions of the DRP, has passed the final assessee order determining the total income of Rs. Nil after setoff of brought forwarded unabsorbed losses and unabsorbed depreciation of Rs 144,97,34,540/- and passed the order u/s 143(3) r.w.s 144C(13) of the Act dated 22.10.2019.

4. Subsequently, the Pr.CIT on examination of the facts and the assessment record observed that the A.O has not conducted any enquiry in respect of ISOP and ESOP expenditure, which is in the nature of capital expenditure and do not qualify for deduction u/s 37 of the Act. The Pr.CIT is of the opinion that the assessment order passed u/s 143(3) r.w.s 144C(13) of the Act is erroneous and prejudicial to the interest of revenue and issued notice u/s 263 of the Act dated 20.01.2022 read as under:

3.1 The assessee company claimed expenses of Rs. 122lakh on account of contribution for purchases of shares of its ultimate holding co. i.e. the Procter and Gamble Company, USA under the International Stock Ownership Plan (ISOP) during the year. Also, it claimed stock compensation expenses of Rs. 155 lakh under Employees Stock Options Plan (ESOP), during the year. The said aggregate expenses of Rs.277 lakh (i.e. Rs. 122 lakh+ Rs.

155 lakh) cannot be claimed by the assessee u/s. 37 of the Act in view of the following:

(i) Both ISOP and ESOP expenses are capital in nature, and thus, do not qualify deduction u/s 37(1) of Income Tax Act.

(ii) ESOP expenditure is neither incurred nor accrued during the relevant year hence, it cannot be considered a deductible expenditure. Every ESOP scheme comes with various conditions which inter-alia includes a minimum period of employment with the company i.e. vesting period. There is a certain time period within which the employee after the ESOP getting vested gets an opportunity to exercise the option i.e. Exercise period. The issue of shares is not crystallized till the date on which the employee exercises the option and hence any expenditure debited during the vesting period remains contingent in nature, and therefore, does not qualify deductibility as per section 37(1).

The mistake in allowing the aforesaid expense has resulted in underassessment of income of Rs. 2.77 crore. In the light of above fact and order passed u/s. 143(3) r.w.s. 144C(13) dated 22.10.2019, the quantum of income to the tune of Rs. 2.77 crore has escaped levy of tax. re has

4. The Assessing Officer was required to examine and disallow the aforesaid claims of reduction from taxable income. However, no such examination or disallowance was made. Failure of the Assessing Officer to make necessary enquiries which were warranted in the facts and circumstances of the case and under the provisions of law and failure to disallow the aforesaid claims of reduction has rendered the assessment order dated 22.10.2019

erroneous in so far it is prejudicial to the interests of revenue.

5. It is therefore proposed to revise the assessment order dt. 19.10.2019 under section 263 of the Income Tax Act, 1961, being erroneous in so far as it is prejudicial to the interests of revenue."

5. In compliance to the notice, the assessee has filed the reply dated 28.01.2022 referred at page 3 and 4 of the Pr.CIT order as under:

"In this regard, the Assessee wishes to place on record the objection to the proposed action of revision of assessment order dated 19.10.2019 passed by the learned assessing officer ('AO'), being erroneous in so far as it is prejudicial to the interests of revenue. We submit that notices were issued to the assessee from time to time including detailed questionnaires and show cause notice. Against the said notices, your assessee had furnished all the details and information sought for. The details so furnished by the assessee was duly verified and examined by the assessing officer and after application of his mind to the facts of the case, an assessment order was passed for the year under consideration. Therefore, the reason for invoking section 263 that no proper enquiry conducted by AO at the time of assessment proceeding does not hold true.

Merits of the Case

1. At the outset it is submitted that the ESOP and ISOP expenses claimed by the assessee relates to the stock options / benefits granted by the parent company to the employees of the assessee and that these do not relate to

any scheme or plan relating to shares / stocks issued by the Assessee itself. Therefore, the entire edifice of the disallowance, that the expenditure is capital in nature, is baseless and, probably, without proper appreciation of the facts of the case.

Secondly, ESOP expenses are in the form of an incentive to eligible employees, per their employment criterion. The expenses have been incurred wholly and exclusively for the purpose of the assessee company's business and are thus fully allowable as expense under section 37 of the Act. ISOP expenses are incurred during the year, i.e., there is an actual cash outflow for the benefit of the employees and hence cannot be contingent/notional in nature.

The complete details of ESOP and ISOP expenses are given under note 28 of the audited financial statements for Financial Year 2014-2015, as enumerated below:

Note 28 (a) International Stock Ownership Plan (Stocks of the Ultimate Holding Company)

The Procter and Gamble Company, USA has an "International Stock Ownership Plan" (employee share purchase plan) whereby specified employees of its subsidiaries have been given a right to purchase shares of the Ultimate Holding Company i.e. The Procter and Gamble Company, USA. Every employee who opts for the scheme contributes by way of payroll deduction up to a specified percentage (upto 15%) of base salary towards purchase of shares on a monthly basis. The Company contributes 50% of employee's contribution (restricted to 2.5% of his base salary). Such contribution is charged under employee benefits expense.

The shares of The Procter & Gamble Company, USA are listed with New York Stock Exchange and are purchased on behalf of the employees at market price on the date of purchase. During the year ended March 31, 2015, 8 696.14 (Previous year 7 867.14) shares were purchased by employees at weighted average fair value of Rs. 5 171.14 (Previous year Rs. 4 806.19) per share.

The Company's contribution during the year on such purchase of shares amounting to Rs. 122 Lakhs (Previous year Rs. 102 Lakhs) has been charged under employee benefits expense under Note 23. (b) Employees Stock Options Plan (Stocks of the Ultimate Holding Company)

The Procter and Gamble Company, USA has an "Employee Stock Option Plan" whereby specified employees of its subsidiaries covered by the plan are granted an option to purchase shares of the Ultimate Holding Company i.e. The Procter and Gamble Company, USA at a fixed price (grant price) for a fixed year of time. The shares of The Procter & Gamble Company, USA are listed with New York Stock Exchange. The Options Exercise price equal to the market price of the underlying shares on the date of the grant. The Grants issued are vested after 3 years and have a 5/10 year life cycle.

Stock compensation expense of Rs. 155 Lakhs (Previous years Rs.250 Lakhs) has been charged under employee benefits expense under Note 23.

Prayer: In view of above submissions and details already available in records, the contentions given under point 3 of your notice for the hearing dated 20-01 2022 stands invalidated and therefore notice for revision proceedings u/s 263 of the Act be withdrawn.

2. Further, with regard to point no. 4 of the notice, wherein your goodself has alleged that the assessing officer has not done any examination of claims is incorrect. The complete set of audited financial statements along with Tax Audit report and Certificate in form 3CEB was submitted and available in the records of the assessment proceedings and duly discussed during the course of proceedings.

In our view, not putting this fact (of examining the records and audited statements) in the assessment order would not call for revision of order and issuance of notice under section 263 of the Act.

The basic features of Section 263 are that the Principal Commissioner may revise any order of assessment provided it is erroneous and prejudicial to the interests of the revenue, which in view of above submissions does not stand correct, as the Assessing office has fully applied his mind and passed order after considering the material available on record. Thus, the order for FY 2014 15 is not erroneous and prejudicial to the interest of the revenue and has been passed by the Assessing officer considering all facts, records, submissions and audited accounts in place.

Also, the expenses of similar nature have been debited in the past years as well and duly validated while examined in the assessment proceedings.

Explanation 2 has been inserted by the Finance Act, 2015 w.e.f 1-6-2015. The explanation sets out what orders passed by the Assessing Officer (the "AO") constitute orders which are erroneous in so far as they are prejudicial to the interests of the Revenue. The

Memorandum of Objects and Reasons to the Finance Bill, 2015 (2015) 371 ITR 233 (St) specifies that the issue of what constitutes orders erroneous and prejudicial to the Revenue is a contentious one.

Thus twin Conditions are to be satisfied for the exercise of power u/s 263 of the Act/Basic Principles.

i. As in the case of Malabar Industrial Co. Ltd. vs. CIT[2000] 243 ITR 83(SC), the Supreme Court held that there must be two conditions namely that the order of assessment is erroneous and that the order is prejudicial to the interests of the Revenue which must be satisfied before the Commissioner may invoke his powers under Section 263 of the Act. This condition in the present case is not applicable as the assessment order passed by the assessing office is not erroneous or prejudicial to the interest of the revenue.

ii. If two views are possible, and the AO has adopted one of those views, the order of assessment cannot be prejudicial to the interests of the Revenue. However, when the Assessing Officer does not apply his mind to the issue at hand or violates any of the principles of natural justice, the order shall be prejudicial to the interests of the Revenue. Also, an incorrect assumption of facts or incorrect application of law by the AO would make the order of assessment erroneous and prejudicial to the interests of the Revenue. This condition is again not applicable in the present case, as the assessing office was very vigilant and aware of the facts and past assessments and duly applied the principles of law before passing the assessment order.

Without prejudice to above your assessee wishes to highlight that it has filed appeal before Hon'ble ITAT

against the adjustments/ additions made in the assessment order for AY 16-17. The Assessee Company is hopeful of getting significant relief from the Hon'ble ITAT."

6. Whereas the Pr.CIT was not satisfied with explanations with respect to claim of ESOP & ISOP expenditure and the matter/issue needs to be verified and reasons for claim should be justified which the A.O. has not verified. The Pr. CIT observed that the order passed U/sec143(3) r.w.s 144C(13) of the Act is erroneous and prejudicial to the interest of revenue and invoked the provisions of Explanation 2 to Sec. 263 of the Act and has set aside the assessment and issued directions to the A.O. and passed the order. The observations of the Pr.CIT are at page 17 Para 10 of the order read as under:

10. In view of the legal position discussed above, the Assessing Officer's failure in not examining the impugned issue by way of enquiries/verification that were TAX DEPARTMEN required in this case, has rendered the assessment order dated 05.12.2019 erroneous in so far as it is prejudicial to the interests of the revenue. Both the conditions specified u/s.263 of the Act are satisfied in this case and it is a fit case to invoke provisions of Explanation 2 to the said section. Accordingly, the assessment order dated 22.10.2019 passed by the Assessing Officer under section 143(3) r.w.s 144C(13) of the Act is set aside, and

the Assessing Officer is directed to conduct requisite enquiries along the lines discussed above and frame the order of assessment de novo. Certain submissions made by the assessee need to be closely examined during the course of fresh assessment proceedings, including the assertion that that both ESOP and ISOP expenses relate to stock options/benefits granted by the parent company to the employees of the assessee, and do not relate to any scheme issued by the assessee itself. On the face of it, in the absence of any further elucidation, it is not understood as to how this line of argument establishes the fact that the expenses claimed under these heads were not capital in nature. Similarly, submissions made w.r.t the ISOP Plan - the stand that there was an actual cash outflow by the assessee company for an ascertained liability, etc - also need to be closely examined & carried to its logical conclusion. In this process, adequate opportunity of being heard should be afforded to the assessee to file details and furnish its explanation.

7. Aggrieved by the revision order, the assessee has filed an appeal before the Hon'ble Tribunal. At the time of hearing, the Ld.AR submitted that the Pr. CIT has erred in set aside the order u/s 143(3) r.w.s 144C(13) of the Act, which does not satisfy the twin conditions of erroneous and prejudicial to the interest of the revenue and also directing the A.O. to frame de novo assessement. The Ld.AR submitted that the explanation 2 to sec 263 of the Act ought to be considered only when the AO has not applied his mind,

and the facts are to be verified and no enquiry is conducted. The Ld. AR emphasized that the assessee has complied with the notices and the clarifications were filed. The Ld.AR submitted that the ESOP & ISOP expenses are to be allowed and supported the claims with the judicial decisions and substantiated the submissions with the paper book and prayed for allowing the appeal.

8. Contra, the Ld.DR mentioned that the A.O has not dealt on the claim of ESOP& ISOP nor conducted enquiry /examined the facts and the assessee has filed the details in compliance to the notice on the other issues. Further the Ld.DR made submissions on the application of the provisions and explanation 2 to section 263 of the Act as the AO has not verified claims , which is in the nature of the capital expenditure and supported the order of the Pr.CIT

9. We heard the rival submissions and perused the material available on record. The Ld.AR contentions are that the order passed by the A.O. does not satisfy the twin conditions that (i) erroneous and (ii) prejudicial to the interest of the revenue. The Ld. AR further submitted that the Pr. CIT is of the opinion that the AO has not

conducted enquiry on ISOP and ESOP expenditure which the assessee has claimed in the books of accounts and the note 28 of the audited financial statements provide complete details of ESOP and ISOP expenses. The Pr.CIT has observed that the assessee has incurred expenditure of ESOP and ISPO which is in the nature of capital expenditure and the A.O. has not verified these facts and there is failure on the part of the A.O. to conduct enquires. The Ld. AR submitted that though the A.O. has not made observations on these claims in the order but on the question of merits of the claim, the ESOP&ISOP expenses are revenue expenditure and was claimed in the Audited financial statements and supported the submissions with the judicial decisions and factual paper book. At this stage the Bench has mentioned to the Ld.AR that the discussions are in respect of the revision proceedings and not on allow ability of expenses.

10. Prima facie, the AO has not verified these aspects though the Ld.AR has been emphasising that it tantamount to multiplicity of the litigation. But the question is that the Pr. CIT has invoked the explanation 2 to Sec. 263 of the Act where the AO has failed to make enquiries. We are of the opinion that the Pr.CIT is

correct in making the observations that there is no enquiry conducted by the AO nor has applied his mind on the disputed issues. The Pr. CIT has directed the AO to verify and examine the expenses claimed are not in the nature of capital expenditure and make de nova assesement. We considering the facts, circumstances and submissions modify the directions of the Pr.CIT to the Assessing officer to be limited to the extent of verification of facts with the material information on ESOP&ISOP expenses and decide on merits and the assessee should be provided adequate opportunity of hearing and to submit the details and explanations expeditiously. Accordingly, the grounds of appeal of the assessee are partly allowed for statistical purposes.

11. In the result, the appeal filed by the assessee is partly allowed for statistical purposes.

Order pronounced in the open court on 29.08.2022.

Sd/-
(BASKARAN BR)
ACCOUNTANT MEMBER

Sd/-
(PAVAN KUMAR GADALE)
JUDICIAL MEMBER

Mumbai, Dated 29.08.2022

KRK, PS

Copy of the Order forwarded to :

1. The Appellant
2. The Respondent.
3. The CIT(A)
4. Concerned CIT
5. DR, ITAT, Mumbai
6. Guard file.

//True Copy//

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आदेशानुसार/ BY ORDER,

(Asst. Registrar)
ITAT, Mumbai