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

BEFORE SHRI N.V. VASUDEVAN, VICE PRESEIDENT
AND
SHRI PADMAVATHY S, ACCOUNTANT MEMBER

IT(TP)A No.274/Bang/2022
Assessment year : 2017-18

Cerner Healthcare Solutions India Private Limited [earlier Cerner India Health Services Pvt. Ltd.], 10th Floor, Wing B, Block H2, Mountain Ash, Manyata Embassy Business Park, Nagawara, Bangalore – 560 045. **PAN: AAFCC 8750R**	Vs.	The Deputy Commissioner of Income Tax, Circle 2(1)(1), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Shri Sumeet Khurana, CA
Respondent by	:	Shri V S Chakrapani, CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	30.08.2022
Date of Pronouncement	:	06.09.2022

O R D E R

Per Padmavathy S., Accountant Member

This appeal is by the National Faceless Assessment Centre, Delhi [NFAC], Delhi passed us/. 143(3) r.w.s. 144C(3) r.w.s. 144B of the Income-tax Act, 1961 [the Act] dated 25.2.2022 for the assessment year 2017-18.

2. The assessee raised grounds pertaining to following issues:-

1. Disallowance of ESOP expenditure amounting to Rs.42,64,919 u/s. 37 of the Act (Ground Nos. 2 to 2.9)

2. Disallowance of customs duty amounting to Rs.5,74,199 (Grounds 3 to 3.2)

3. Disallowance of Rs.50 lakhs u/s. 43B (Grounds 4 to 4.2)

4. Ground No.1 is general and ground No.5 is consequential not warranting separate adjudication.

3. The assessee is engaged in the business of providing software development and Information Technology enabled Services [ITeS] of various healthcare solutions that are designed and developed by Cerner US. The assessee has STPI units in Bangalore and Kolkatta. The assessee filed the return of income for the AY 2017-18 on 30.11.2017 declaring total income at Rs.36,25,06,030. The case was selected for scrutiny and notice us/. 143(2) of the Act was duly served on the assessee. Since the assessee had international transactions with its AE, reference was made to the TPO. The Transfer Pricing Officer [TPO] arrived at a TP adjustment of Rs.24,82,36,841. The AO passed the draft assessment order incorporating the TP adjustment and also made disallowance towards the Employee Stock Option Plan [ESOP] expenditure incurred by the assessee and disallowed customs duty and disallowance u/s. 43B of the Act. Aggrieved, the assessee filed its objections before the DRP, who upheld the draft assessment order. In accordance with the directions of the DRP, the AO passed the final assessment order against which the assessee is in appeal before the Tribunal.

4. The assessee has entered into Advance Pricing Agreement [APA] and therefore did not raise any grounds pertaining to TP adjustment before the Tribunal. The rest of the issues raised by the assessee are adjudicated in the following paragraphs.

ESOP expenditure

5. The AO noticed that in the Notes to the Accounts of the financials, the asse has claimed an expenditure of Rs.42,64,919 as ESOP expenses. The AO issued a show cause notice to the assessee asking for details by stating that if there is a loss on account of issue of shares to the employees, the same should be reflected in the books of the holding company and not in the books of account of the assessee. The assessee submitted that the ESOP expenses incurred by the assessee are cross charged by the holding company towards the difference between the fair market value of the shares on the date of grant and the value arrived at the end of the vesting date for the shares allotted to the employees of the assessee company. The assessee further submitted that the ESOP allotment is done as a compensation for services rendered by its employees, to attract and retain qualified employees and to motivate them to render continued services that would contribute to the growth of the company. Therefore the assessee submitted that the ESOP expenditure is incurred wholly and exclusively for the purpose of the business of the assessee and eligible for deduction u/s. 37.

6. The AO did not accept the submissions of the assessee and disallowed the ESOP expenditure on the ground that the discounted price of shares is only notional in nature and not a crystallized one. The AO further held that the expenditure booked by the assessee and reimbursed to the holding company is a fictitious expenditure and therefore cannot be allowed as a deduction u/s.37.

7. Against the objections raised by the assessee, the DRP held that the expenditure incurred is capital in nature and the expenditure that relates to issue of shares is a capital in nature and therefore upheld the disallowance made by the AO.

8. Before us, the ld. AR reiterated the submissions made before the lower authorities. The ld. AR further s submitted that in the APA agreement entered into by the assessee with CBDT (pages 516 to 561 of the PB) in the operating expenses, the expenses incurred towards ESOP benefit is treated as operating expenses, therefore the ld.AR contended that the revenue on the one hand cannot treat the expenditure as capital in nature; and on the other hand, include it as part of operating expenses for transfer pricing purposes. The ld. AR drew our attention to the decision of the coordinate Bench of the Tribunal in assessee's own case where the similar issue is considered and it was held that the expenditure incurred towards ESOP is allowable u/s.37(1) of the Act.

9. The ld. DR supported the orders of the lower authorities.

10. We have considered the rival submissions and perused the material on record. We notice that the holding company has cross charged the assessee towards ESOP expenses by raising debit notes on a quarterly basis which is placed on record in page 377 to 380 of the PB. The shares of the holding company are issued at a discounted value to the employees of the assessee company and the holding company cross charges the assessee for the difference between the fair market value and the date of grant and the value arrived at the end of the vesting period. Our attention was also drawn to the fact that these expenditure are debited to the P&L account of the assessee (page 456 of PB). It was also submitted by the ld. AR that the holding company cross charges the cost towards the ESOP over the vesting period. We notice that the coordinate Bench of the Tribunal in assessee's own case for the AY 2016-17 has considered the same issue and has held as under:-

> "4. After hearing both the parties we find that similar issue came up for consideration of the Tribunal in the case of Novo Nordisk India (P.) Ltd. (2014) 63 SOT 242 Bang-Trib) wherein it is held as under:-
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> > "In the present case, there is no dispute that the liability has accrued to the assessee during the previous year. The only question to be decided is as to whether it is the expenditure of the assessee or that of the parent company. We are of the view that the observations of the CIT(A) in para 5.6 of his order that these expenses are the expenses of the foreign parent company is without any basis and lie in the realm of surmises. The foreign parent company has a policy of offering ESOP to its employees to attract the best talent as its work force. In pursuance of this policy of the foreign parent company, allowed its subsidiaries/affiliates across the world to issue its shares

to the employees. As far as the assessee in the present case which is an affiliate of the foreign parent company is concerned, the shares were in fact acquired by the assessee from the parent company and there was an actual outflow of cash from the assessee to the foreign parent company. The price at which shares were issued to the employees was paid by the employee to the Assessee who in turn paid it to the parent company. The difference between the fair market value of the shares of the price at which shares were issued to the employees was met by the Assessee. This factual position is not disputed at any stage by the revenue. In such circumstances, we do not see any basis on which it could be said that the expenditure in question was a capital expenditure of the foreign parent company. As far as the assessee is concerned, the difference between the fair market value of the shares of the parent company and the price at which those shares were issued to its employees in India was paid to the employee and was an employee cost which is a revenue expenditure incurred for the purpose of the business of the company and had to be allowed as deduction. There is no reason why this expenditure should not be considered as expenditure wholly and exclusively incurred for the purpose of business of the assessee.

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With regard to the observations of the CIT(Appeals) that the ESOP actually benefits only the parent company, we are of the view that the expenditure in question is wholly and exclusively for the purpose of the business of the assessee and the fact that the parent company is also benefited by reason of a motivated work force would be no ground to deny the claim of the assessee for deduction, which otherwise satisfies all the conditions referred to in section 37(1)

The facts and circumstances of the present case, the expenditure in question was wholly and exclusively for the purpose of the business of the assessee and had to be allowed as deduction as a revenue expenditure.

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

> 5. In view of the above binding decision of the Coordinate Bench we allow the grounds taken by the assessee."

11. Respectfully following the decision of the coordinate Bench, we hold this issue in favour of the assessee that the expenditure incurred by the assessee towards ESOP expenses is an allowable claim u/s.37(1) of the Act.

Addition towards customs duty

12. The AO during the course of assessment noticed that the customs duty paid as shown in the ITR is NIL, whereas as per the export import data available with the dept., customs duty paid is at Rs.5,74,199 on the invoice value of Rs.1,08,96,071and assessable value of Rs.1,12,01,650. The AO called upon the assessee to furnish the details of customs duty paid along with supporting documents. The assessee filed a reply that the assessee is operating out of a STPI premises and during the relevant AY, the assessee has not paid any customs duty. The assessee also requested for details from the AO in order to identify the reasons for difference. The AO shared the details as per ITS data in response to which the assessee reiterated that the assessee has not paid any customs duty. The AO made an addition towards the said amount in the absence of documentary evidence filed by the assessee. The DRP confirmed the said addition.

13. The ld. AR submitted that the assessee is STPI unit which is exempt from payment of customs duty. The ld. AR submitted additional evidence in the form of Certificate of procurement of

imported goods where it is stated that the duty forgone to support that the assessee is not required to pay any customs duty. Theld.AR prayed for admission of additional evidence furnished in this regard.

14. We are of the view that the additional evidence goes to the root of the issue and hence admit the same for adjudication of the issue.

15. The ld.DR supported the orders of the lower authorities.

16. We have heard the rival submissions and perused the material on record. We notice that the assessee is a STPI unit and therefore not required to pay customs duty on imports. This fact is also supported by the additional evidence furnished by the ld.AR on sample basis. Further, the lower authorities have not brought anything contrary on record to support that the assessee has paid the customs duty. We notice that the lower authorities have relied on the ITS data to make the addition which according to the ld.AR does not belong to the assessee. We see merit in the submission of the ld. AR that the amount of customs duty is not debited to the P&L account and this fact has also not been factually proved by the revenue. In the light of the above discussion, we are of the considered view that no addition towards customs duty is warranted and therefore the addition made in this regard is deleted.

Disallowance of Rs.50 lakhs u/s. 43B

17. The assessee's return was processed u/s.143(1)of the Act where the CPC has disallowed the difference between the 43B disallowance

amount reported in the return of income and the disallowance reported u/s.43B in clause 26 of the tax audit report. The AO while passing the impugned assessment order has considered the income as determined in the intimation passed u/s. 143(1) of the Act thereby making the addition towards the same in the assessment order u/s. 143(3). The assessee raised objections before the DRP, wherein the assessee submitted the detailed reconciliation of disallowance made u/s. 43B as below:-

Sl No.	Disclosure as per Form 3CD	Amount in INR
1.	Clause 26(i)(B)(b) – incurred during the previous year and not paid before the due date of filing return of income – Leave encashment	13,662,865
2.	Clause 26(i)(B)(b) – incurred during the previous year and not paid before the due date of filing return of income – Gratuity	17,000,653
	Total amount of disallowance u/s. 43B	30,663,518
3.	Clause 26(i)(A)(a) - Pre-existed on the first day of the previous year; paid during the year	(5,000,000)
	Net amount to be disallowed under section 43B	25,663,518

18. The DRP confirmed the disallowance of Rs.50 lakhs by observing that

> "2.3.2 The liability is a pre-existing one which means that the assessee has neither the paid the sums in the previous year's relevant to the respective assessment years or on or before filing the return of income u/s 139 of the Act. Thus, Rs.50,00,000 is not a sum towards payment of any gratuity that has become payable during the previous year relevant to the current assessment year. The object of the registration of the fund/approval is to give benefits of deduction of such expenditure to those items to the extent provided in section40A(7) of the Act. It is not possible to

> claim deduction under u/s 43B of the Act on payment basis, of an expenditure disallowed specifically as per section 40A(7) of the Act. In that event, the purpose of the section 40A(7) would be defeated if such deduction is allowed in any other provisions, especially in this case under Section 43(B) of the Act. Further, the deduction claimed in section 40A(7) is provision for employees' gratuity fund, whereas in section 43(B) the sum payable towards gratuity fund by employer pertaining to previous year on or before filing of return of income U/s 139(1) of the Act. Now, the assessee, therefore, cannot claim deduction on the same amount under garb of sec 43B(b), which is not applicable in this case. Hence the plea of the assessee is rejected."

19. Before us, the ld AR submitted that the amount disallowed pertains to the liability pre-existing on the 1st day of the previous year which is paid during the year under consideration and therefore eligible for deduction u/s. 43B of the Act. He also submitted that the assessee has netted off the amount of disallowance towards provision for leave encashment and gratuity (Clause 26(i)(B)(b) of Form 3CD) with the amount paid towards the opening balance of the provision (Clause 26(i)(A)(a) in the computation of income and the reconciliation would evidence this fact. The ld. AR therefore submitted that the assessee has disallowed the correct amount as per the provisions of section 43B and no disallowance is warranted in this regard.

20. The ld. AR in the additional evidence submitted that the approval given by the revenue for the gratuity scheme of the assessee and also evidence supporting the payment of gratuity amount (pg.602-603 of PB).

21. The ld. DR supported the orders of the lower authorities.

22. We have heard the rival submissions and perused the material on record. From the reconciliation which is reproduced above, it is clear that the assessee has netted off 43B disallowance against the payment of gratuity which is allowable. Further, the DRP has invoked the provisions of section 40A(7) by stating that the amount is not allowable u/s. 43B if the expenditure is disallowed which is applicable to unapproved gratuity fund. This is factually incorrect as we notice from the additional evidence submitted by the ld. AR where the gratuity fund of the assessee is approved by the revenue vide letter dated 29.5.2015 w.e.f. 20.2.2015. Further, as per the provisions of section 43B, the provisions made towards gratuity is allowable on payment basis and the assessee has made the payment towards gratuity on 31.3.2017. In view of the above discussion, we hold that the sum of Rs.50 lakhs which is claimed by the assessee is allowable deduction u/s. 43B. The addition made in this regard is therefore deleted and this ground is allowed.

23. In the result, the appeal by the assessee is allowed.

Pronounced in the open court on this 6th day of September, 2022.

Sd/-	Sd/-
(N V VASUDEVAN)	(PADMAVATHY S)
VICE PRESIDENT	ACCOUNTANT MEMBER

Bangalore,
Dated, the 6th September, 2022.
/*Desai S Murthy /*

Copy to:

1. Appellant 2. Respondent 3. CIT 4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.