

IN THE INCOME TAX APPELLATE TRIBUNAL
"F" BENCH, MUMBAI

SHRI PRASHANT MAHARISHI, ACCOUNTANT MEMBER
SHRI RAHUL CHAUDHARY, JUDICIAL MEMBER

ITA No. 6116/MUM/2019
(Assessment Year: 2011-12)

M/s Firmenich Aromatics Production
(India) Pvt. Ltd., [as a successor to
M/s Firmenich Aromatics (India) Pvt. Ltd.],
9th Floor, Arena Space Building,
Plot No. 4, Survey No. 20, Jogeshwari,
Vikroli Link Road, Mumbai - 400060
[PAN: AAACF1621M]

..... Appellant

Vs

Dy. Commissioner of Income Tax,
9(3)(1), Mumbai,
Room No. 215, Aayakar Bhavan,
M.K. Road, Mumbai - 400020

..... Respondent

Appearances

For the Appellant/Assessee : Shri Dhanesh Bafna/Amol Mahajan
For the Respondent/Department : Shri Nishant Somaiya

Date of conclusion of hearing : 20.09.2022
Date of pronouncement of order : 19.12.2022

ORDER

Per Rahul Chaudhary, Judicial Member:

1. By way of the present appeal the Appellant has challenged the order, dated 31.07.2019, passed by the Ld. Commissioner of Income Tax (Appeals)-16, Mumbai [hereinafter referred to as 'the CIT(A)'] for the Assessment Year 2011-12, whereby the Ld. CIT(A) had dismissed the appeal against the Assessment Order, dated 26.03.2015, passed under Section 143(3) read with Section 94CA(4) of the Income Tax Act, 1961 (hereinafter referred to as 'the Act').

2. The Appellant has raised following grounds of appeal:

“Ground No. 1: Assessing the total income of the Appellant at Rs. 27,36,18,810 as against income of Rs. 22,55,54,223

On the facts and in the circumstances of the case and in law, the Hon'ble Commissioner of Income Tax -(Appeals) [CIT(A)] erred in computing the total income of the Appellant at Rs. 27,36,18,810 as against Rs. 22,55.54,223 as declared by the Appellant in its return of income.

2. Ground No. 2: Capitalization of software charges amounting to Rs. 5,52,26,376 debited to Profit and Loss account

On the facts and in the circumstances of the case and in law, the Hon'ble CIT(A) erred in upholding the disallowance made by the Assessing Officer (AO) in relation to recurring software expenses of Rs. 5,52,26,376 debited to Profit and Loss account holding the same to be capital in nature.

The Appellant prays that the aforesaid recurring software expenses are revenue in nature and the disallowance be deleted.

Without prejudice to the above, the Appellant prays that depreciation @ 60% on the amount of expenditure capitalized be allowed.

3. Ground No. 3: Disallowance of expenditure incurred on travelling & conveyance of Rs. 38,17,400

On the facts and in the circumstances of the case and in law, the Hon'ble CIT(A) erred in confirming the ad-hoc disallowance made by the AO in relation to travelling & conveyance expenditure amounting to Rs. 38,17,400.

The Appellant prays that travelling & conveyance expenditure was incurred during the course of its business and the disallowance be deleted.

4. Ground No. 4: Disallowance of expenditure incurred on legal & professional fees of Rs. 52,15,400

On the facts and in the circumstances of the case and in law, the Hon'ble CIT(A) erred in confirming the ad-hoc disallowance made by the AO in relation to legal & professional fees amounting to Rs. 52,15,400.

The Appellant prays that expenditure on legal and professional fees was incurred during the course of its business and the disallowance be deleted.

5. Ground No. 5: Disallowance of interest amounting to Rs. 3,73,326 relating to Capital Work in Progress (CWIP)

On the facts and in the circumstances of the case and in law, the CIT(A) erred in upholding the disallowance made by the AO in relation to interest amounting to Rs. 3,73,326 holding the same to have been incurred towards Capital Work in Progress.

The Appellant prays that the disallowance be deleted.

6. Ground No. 6: Levy of interest under section 234B of the Income-tax Act 1961 ("the Act")

On the facts and in the circumstances of the case and in law, the Hon'ble CIT(A) erred in not adjudicating on the consequential interest under section 234B of the Act.

The Appellant prays that the consequential interest be deleted.

7. Ground No. 7: Initiating penalty proceedings under section 271(1)(c) of the Act

On the facts and in the circumstances of the case and in law, the Hon'ble CIT(A) erred in not adjudicating on the initiation of penalty proceedings under section 271(1)(c) of the Act.

The Appellant prays that it has not concealed any particulars of income or furnished inaccurate particulars of income and the AO be directed to set aside the penalty proceedings initiated under section 271(1)(c) of the Act.

3. Brief facts of the case are that the Appellant is a company engaged in the business of manufacture of flavors & fragrances. The Appellant filed return of income on 30.11.2011 declaring total income of INR 22,55,54,223/-. The return was selected for scrutiny. In reference made under Section 92CA(1) of the Act, the Transfer Pricing Officer accepted the international transactions undertaken by the Appellant with the Associated Enterprises to be at arm's length. The assessment

was thereafter completed under section 143(3) read with section 94CA(4) of the Act vide Assessment Order, dated 26.03.2015. The Assessing Officer made following additions/disallowance (i) disallowed Software Charges of INR 3,86,58,463/- and capitalized the same (ii) disallowed expenses amounting to INR 90,32,800/- under heads of travelling and conveyance and legal and professional fees, and (iii) disallowed interest expense of INR 3,73,326/-, and capitalized the same by adding the same to capital work-in-progress. The aforesaid additions/disallowances were also sustained by the CIT(A) and therefore, the Appellant is in appeal before us on the grounds reproduced in paragraph 2 above which are taken up seriatim hereinafter.

Ground No. 1

4. Ground No. 1 is general in nature and therefore, does not require adjudication

Ground No. 2

5. Ground No. 2 relates to capitalization of software charges amounting to INR 5,52,26,376/- debited to Profit & Loss account.
6. During the assessment proceedings, the Assessing Officer noticed that the Appellant debited to the Profit & Loss Account INR 9,00,77,826/- as 'Software Charges' under Schedule 17 - 'Operating Administrative, and Selling Expenses'. In response to the query raised by the Assessing Officer, vide letter dated 13.02.2015, the Appellant submitted reply, vide letter dated 02.03.2015, giving break-up of the Software Charges. Out of Software Charges of INR 9,00,77,826/-, the Appellant claimed

that expenses of INR 3,48,51,510/- pertain to cost of Software Development/acquisition which was treated as capital expenditure while computing taxable income whereas the balance amount of INR 5,52,26,376/- was in the nature of recurring, maintenance and usages charges which were claimed as Revenue expenditure by the Appellant in the return of income. The Assessing Officer, not being satisfied with the explanation furnished by the Appellant, disallowed deduction for INR 5,52,26,376/- by treating the same as capital expenditure and allowed depreciation on same at the rate of 30%. Thus, making addition of balance amount of INR 3,86,58,463/-.

7. Being aggrieved, the Appellant carried this issue in appeal before CIT(A). Before the CIT(A) dismissed the ground raised by the Appellant holding as under:

“4.2.5 I have considered the material available on the records and the contention raised by the Ld. AO as well as by the appellant. The appellant has placed reliance on the Judgment of Hon'ble Kolkata Bench of Tribunal in case of DCIT V. Price Waterhouse Coppers Pvt. Ltd. ITA No. 1521/Kol/2013 dated 13.07.2016 wherein expenditure was incurred on account of an annual license fee for a specific number of users for using the Lotus Communications System for a period of one year payable to Oracle India Pvt. Ltd. Towards technical support on Oracle software. The basis on which the Tribunal has passed said judgment & been applied in the case of the appellant and it was gathered that, the appellant has not provided any description in respect of the expenses incurred by them. Further, the software was purchased by the parent company of the appellant and was transferred to the appellant which could not fulfill the condition that, any technical support was provided by the parent company pay recurring services were provided.

4.2.6 It is also pertinent to mention herein that the agreement submitted by the appellant does not contain the details of first

two invoices, which were considered as revenue expenditure by the appellant. Further, the appellant was previously using different types of software's and replaced all by one software which was purchased from the parent company which clearly states that the said software was not for a year or two, it would be definitely for several years. Accordingly, the AO has correctly considered the expenditure incurred by the appellant in respect of software expenses as capital expenditure. Hence, this ground of appeal is dismissed."

8. Being aggrieved, the Appellant is now in appeal before us challenging the order passed by CIT(A).
9. Ld. Authorised Representative for the Appellant had contended that the Appellant had been using Oracle Software for financial accounting, stock maintenance and other purposes. During the relevant previous year, a new software, i.e., S3 ERP (being SAP software developed/acquired by Firmenich SA – Switzerland) was adopted/implemented by the Appellant w.e.f. 01.10.2010. The implementation of the software was done in a phased manner with the help of SAP technical support. Once implemented, the software needed constant repairs, creation of back-up and updation to ensure consistent working of the software. The recurrent expenses included professional charges incurred towards maintenance and installation of system, internet subscription and other expenses required for its usage. The expenses disallowed by the Assessing Officer were in the nature of software maintenance expenses and could not have been characterized as capital expenditure. The Appellant had entered into Information System Service Agreement with Firmenich SA for providing services for consistent performance of the software application. Firmenich SA charged to the Appellant the cost allocated to the group

companies (including the Appellant) on the basis of usage. The Appellant had submitted a report by the external auditor in respect of specific cost and recurrent costs charged to the Appellant along with detailed sheet of total cost of IS rebilling software charges (with the allocation sheet) and invoices issued by the Firmenich SA during the course of the assessment proceedings. The software charges debited in Profit and Loss Account amounting to INR 9,00,77,886/- represented cost allocated to the Appellant in relation to software development/acquisition of INR 3,48,51,510/- as well as recurrent maintenance cost of INR 5,52,26,376/-.

10. Per contra, the Ld. Departmental Representative submitted that details of the expenses and basis of allocation were not furnished by the Appellant. The Appellant had failed to provide necessary documents/details to substantiate the claim and therefore, the Assessing Officer/CIT(A) was justified in making/sustaining the addition.
11. We have considered the rival submission and perused the material on record.
12. The Appellant had placed on record copy of Information System Services Agreement between Firmenich SA and the Appellant executed on 14.10.2011 (hereinafter referred to as 'the IS Service Agreement'). Article 2.3.1 of IS Service Agreement gave details of recurring services with Schedule A providing details of Recurrent Services Fee. Schedule B of the IS Service Agreement provided details of Specific Service Fee. The Appellant has also placed on record invoice dated 21.05.2010 (CHF 269,213), 31.07.2010 (USD 14,416), 30.04.2011 (USD

1,267,907.94) and 30.04.2011 (USD 1,038,336.64). Perusal of the details placed at page 68 and 69 of the paper book show that the Appellant has been charged distinction between Specific Services Fee and Recurrent Services Fee. The same also give details of estimated cost as well the allocation key. However, the report of the external auditor furnished by the Appellant, which also gives details of allocation on the basis of allocation keys, has been issued on 15.02.2013 and covers period starting from 01.07.2011 to 30.06.2012 and therefore, does not cover the relevant previous year. The Appellant has also furnished the details of software licenses utilized by the Appellant (placed at page 62 and 63 of the paper book) in respect of which the Appellant has been '*re-billed*'. The facts that the aforesaid documents/details were filed before the Assessing Officer/CIT(A) has not been disputed by the Revenue. While the Assessing Officer referred to some of the documents filed by the Appellant, the CIT(A) has returned a finding that the Appellant has not provided any description in respect of expenses incurred. The finding returned by the CIT(A) is contrary to the material on record. Further, while concluding that the expenditure incurred by the Appellant in respect of software was capital in nature, the CIT(A) has proceeded on the presumption that the software would have useful life for many years. The approach adopted by the CIT(A) cannot be countenanced as it is based upon presumption rather than examination of facts. On the other hand, the details submitted by the Appellant are not supported by the certificate from the external auditor which, though giving details of allocation keys, does not cover the relevant previous year. The Assessing Officer has also observed that while the IS Service Agreement

was executed on 14.10.2011, the expenses claimed pertain to period prior to execution of the IS Service Agreement (as can be seen from the invoice date). In view of the aforesaid, we deem it appropriate back to the file of Assessing Officer for de-novo adjudication after giving the Appellant an opportunity of being heard. Ground No. 2 raised by the Appellant is treated as allowed for statistical purposes.

Ground No. 3 & 4

13. Ground No. 3 relates to disallowance of expenditure incurred on travelling & conveyance of INR 38,17,400/-, whereas Ground No. 4 relates to disallowance of expenditure incurred on legal & professional fees of INR 52,15,400/-.

14. During the assessment proceedings the Assessing Officer noticed that there was 25% increased in gross receipts as compared to earlier years whereas there was increase of 90% in travelling and conveyance expenses as well as legal and profession fees. Therefore, vide letter dated 13.02.2015, the Appellant was asked to furnish relevant documents/details in support of claim of deduction in respect of the aforesaid expenditure. Since, the Appellant failed to furnish the relevant details, the Assessing Officer proceeded to make disallowance. The Assessing Officer restricted the claim of the deduction to 140% of the expenses allowed in the immediately preceding Assessment Year and disallowed the amount claimed in excess of the same. Thus, the Assessing Officer disallowed INR 38,17,400/- and INR 52,15,400/- as excess travelling & conveyance expenses, and legal & professional fee, respectively. An aggregate disallowance of INR 90,32,800/- was made by the Assessing Officer.

15. Being aggrieved, the Appellant preferred appeal before the CIT(A) on this issue.
16. The Appellant moved Application for Additional Evidence under Rule 46A of the Income Tax Rules, 1962. It was submitted that the Appellant was prevented from submitting the additional evidence as the Appellant had changed the accounting software and for the reason that the Appellant was not put to notice. The additional evidence filed by the Appellant was sent to the Assessing Officer for remand report. The Assessing Officer submitted remand report, dated 18.10.2018 and in response to the same the Appellant filed letter, dated 25.01.2019. After taking into consideration the remand report and their response received to the Appellant, the CIT(A) confirmed the order passed by Assessing Officer holding that despite reasonable opportunity having been granted, the Appellant has failed to substantiate the expenses in the remand proceedings. There was huge increase in expenses as compared to the revenues for which no supporting documents were submitted by the Appellant. The CIT(A) also observed that despite incurring expenses of INR 9 Crore, the Appellant was not able to provide party-wise segregation details and co-relate the invoices with the expenses debited to the Profit & Loss Account.
17. Being aggrieved, the Appellant is now before us challenging the order passed by CIT(A).
18. We have considered the rival submissions and perused the material on record. The Assessing Officer had made the disallowance for the reason that the increase in the expenses

was not matched by the corresponding increase in the Revenue. Before CIT(A), the Appellant had produced additional evidence in the form of invoices related to legal & professional charged and travelling & conveyance expenses. However, the Assessing Officer wanted party-wise details which the Appellant was admittedly not able to furnish on account of change in the accounting software. In response to the remand report the Appellant had, in his letter dated 25.01.2019, stated that party-wise bifurcation of travelling & conveyance expenses was not available as these were in the nature of reimbursement of expense paid to the employees on the basis of actual expenses incurred by them on travelling & conveyance. On perusal of the remand report dated 18.10.2018, we note that the invoice submitted by the Appellant to substantiate the legal & professional charges and travelling & conveyance expenses were verified by the Assessing Officer on test check basis in the remand proceedings and no infirmity was pointed out in the same. The primary evidence in support of incurring the expenditure was placed before the CIT(A) as additional evidence. Perusal of record shows that the Appellant was also not called upon by the Assessing Officer to submit more/additional invoices in support of the claim. The reason for concluding that the Appellant was not able to support the claim with evidence was that the Appellant did not furnish party-wise details and/or failed to co-relate the expenses debited to Profit & Loss Account. We are not inclined to accept the aforesaid approach adopted by the CIT(A)/Assessing Officer for the reason that the primary fact as well as supporting evidence were placed on record. The finding returned by the CIT(A) that the Appellant had furnished no supporting documents to

substantiate the claim is, therefore, factually incorrect. Further, the CIT(A) and Assessing Officer (in remand proceedings) neither pointed out any infirmity in the same nor the necessity of the detailed break-up asked for by the Assessing Officer. The quantum of disallowance was also computed by the Assessing Officer on ad-hoc basis. In view of the aforesaid, we delete the addition of INR 90,32,800/- made by the Assessing Officer. Ground No. 3 & 4 raised by the Appellant are allowed.

Ground No. 5

19. Ground No. 5 relates to disallowance of interest amounting to INR 3,73,326/- relating to Capital Work in Progress (CWIP).
20. During the assessment proceedings, the Assessing Officer vide letter, dated 13.02.2015, asked the Appellant to furnish the details of capital work-in-progress and state whether any interest expenditure was capitalized. According to the Assessing Officer, no response was received from the Appellant in this regard and therefore, the Assessing Officer presumed that no interest was capitalized as part of work-in-progress. Therefore, after making an observation to the effect that the Appellant had, both, borrowed as well as own funds, and had incurred expenditure for capital work-in-progress out of both, the Assessing Officer disallowed interest expenses of INR.3,73,326/- being 2.15% of capital work-in-progress out of the interest expense of INR 1,85,53,000/- claimed by the Appellant as Revenue expenditure and capitalized the same as capital work-in-progress.
21. Being aggrieved, the Appellant preferred appeal before CIT(A) on this issue. Before CIT(A) it was contended on behalf of the

Appellant that the Appellant had submitted the details of the addition to fixed assets and unsecured loans vide letter dated 24.12.2014 and 26.02.2015. Attention of the CIT(A) was also attracted to the Credit Facility Agreement, dated 19.11.2009 with BNP Paribas as well as working capital credit facility agreement, dated 21.07.2007, with CITI Bank to show that the credit facility has been sanctioned for the purpose of the working capital requirements. However, CIT(A) decline to grant any relief holding as under:

“4.4.3 During the appellant proceeding, the appellant furnished the written submission which find place in para-2 of this order. In the written submission the appellant has stated that the interest bearing fund taken by them from BNP Paribas was for the purpose of normal working capital requirements and the loan from CITI Bank was also for working capital requirement, therefore the perception of the assessing officer that borrowed funds were utilized towards fixed assets is factually incorrect.

4.4.4 I have considered the material available on the records and the contention raised by the Ld. AO as well as by the appellant. The appellant has merely stated that the purpose for which secured loans were taken by them, however they have not submitted any documentary evidence from which it could be justified that the addition to capital work in progress was out of the free funds available with them. In absence of any documents, the AO has correctly capitalized the proportionate interest cost to the capital work in progress. Hence, this ground of appeal is dismissed.”

22. Being aggrieved, the Appellant is now before us challenging the order passed by CIT(A).
23. We have considered the rival submissions and perused the material on record. We note that the Assessing Officer proceeded on presumption interest bearing funds were taken

utilized for capital work-in-progress whereas the CIT(A) brushed aside the documents produced by simply stating that the same only show the purpose and not the actual utilization of the loan amount. The contention of the Appellant is that the interest bearing funds were taken as well as utilized for the working capital requirements. Therefore, the disallowance been made by the Assessing Officer was based on incorrect premise that the same have been used for the purpose of capital work-in-progress and therefore, the same must be deleted. We note that the Appellant had furnished the relevant working capital credit facility agreement and the ledger account showing payment of interest. Further, in the submission filed before CIT(A), the Appellant had contended that the Appellant had own funds of INR 59,38,43,000/- whereas increase in capital work-in-progress is INR 1,59,30,000/-. It is not the case of Revenue that the Appellant did not have sufficient own funds. To the contrary the Assessing Officer had clearly stated that the Appellant also had own funds but proceeds to make disallowance on the presumption that, both, borrowed funds and own funds have been used. The Appellant has furnished the relevant working capital facility agreements and ledger account to show that the unsecured loans were for working capital, and the interest paid thereon is also clearly reflected in the financial statements in Schedule 18 - 'Interest – On working capital loans'. In our view, in absence of any information/circumstances to suggest, in some form or manner, any diversion of working capital loans for funds by the Appellant, in the facts and circumstances of the present case, the presumption drawn by the Assessing Officer cannot be sustained as it has no basis. Accordingly, we overturn the

decision of CIT(A) and delete the disallowance on interest of INR 3,73,326/- made by the Assessing Officer. Ground No.5 raised by the Appellant is allowed.

Ground No. 6

24. Ground No. 6 pertains to levy of interest under Section 234B of the Act, and the same is being disposed off as being consequential in nature.

Ground No. 7

25. Ground No. 7 pertains to initiation of penalty proceedings under Section 271(1)(c) of the Act. The penalty proceedings are separate and distinct from the assessment proceedings. Ground No.7 challenging the initiation of penalty proceedings is disposed off as being premature.

In the result, the present appeal is partly allowed

Order pronounced on 19.12.2022.

Sd/-
(Prashant Maharishi)
Accountant Member

Sd/-
(Rahul Chaudhary)
Judicial Member

मुंबई Mumbai; दिनांक Dated : 19.12.2022
Alindra, PS

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. आयकर आयुक्त(अपील) / The CIT(A)-
4. आयकर आयुक्त / CIT
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR,
ITAT, Mumbai
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

सत्यापित प्रति //True Copy//

उप/सहायक पंजीकार /(Dy./Asstt. Registrar)
आयकर अपीलीय अधिकरण, मुंबई / ITAT, Mumbai