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

SHRI OM PRAKASH KANT, ACCOUNTANT MEMBER
SHRI RAHUL CHAUDHARY, JUDICIAL MEMBER

ITA No. 1696/MUM/2023
(Assessment Year: 2018-19)

LearningMate Solutions Private Limited,
Levels 7 to 10, Techno Park, 74/II,
"C", Cross Road, MIDC, Marol Industrial
[PAN: AAACL9067F) …………… **Appellant**

Vs

Principal Commissioner of Income Tax, Mumbai - 2
Room No. 344, 3rd Floor,
Aayakar Bhavan, Maharishi Karve Road,
Mumbai - 400020 ……………. **Respondent**

Appearance

For the Appellant/Assessee	:	Shri Karthik Natarajan
For the Respondent/Department	:	MS N. V. Nadkarni

Date

Conclusion of hearing	:	25.07.2023
Pronouncement of order	:	31.07.2023

O R D E R

Per Rahul Chaudhary, Judicial Member:

1. By way of the present appeal the Appellant has challenged the order, dated 17/03/2023, passed by the Ld. Principal Commissioner of Income Tax, Mumbai – 2 (Hereinafter referred to as 'the PCIT'] under Section 263 of the Income Tax Act, 1961 (hereafter referred to as 'the Act') whereby the PCIT had set aside Assessment Order, dated 28/01/2021, passed under Section 143(3) read with Sections 143(3A) & 143(3B) of the Act by holding the same to the erroneous and prejudicial to the interest of the revenue.

2. The Appellant has raised following grounds of appeal:

> *"1. In the facts of the case and under the circumstances and in law, the Id. PCIT has erred in passing the order u/s 263 of the Act by holding that the assessment order u/s 143(3) of the Act dated January 28, 2021 passed by the Id. National e-Assessment Centre ("the NeAC) is erroneous in so far as it was prejudicial to the interest of the revenue thereby setting aside the order passed u/s 143(3) by the NeAC.*
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> *2. In the facts of the case and under the circumstances and in law, the ld. PCIT has completely misdirected himself in holding that the Employee Stock Option (ESOP) expenses debited by the appellant to the Profit and Loss Statement were not actual expenses but merely short-receipt of security premium in the hands of the appellant, despite the fact that the said ESOP expenses fulfilled all the necessary requirements of 37(1) of the Act and had been accounted for in compliance of accepted accounting norms and guidelines.*
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> *3. In the facts of the case and under the circumstances and in law, the Ld. PCIT has erred in disregarding the various applicable and binding judicial pronouncements made by the Hon'ble Courts which cover the issue at hand of ESOP expenses squarely, thereby transgressing the principle of judicial discipline.*
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> *4. In the facts of the case and under the circumstances and in law, the Id. PCIT has failed to appreciate the fact that the ESOP expenses were ascertained liability, in the nature of welfare measures for the employees and represented an equity-based incentive to reward employees for their services over the course of their employment"*

3. The relevant facts in brief are that the Appellant, a private limited company, filed return of income for the Assessment Year 2018-19 on 22/11/2018 declaring total income of INR 15.52 Crores. The return was processed under Section 143(1) of the Act. Subsequently, the case of the Appellant was selected for complete scrutiny under E-Assessment Scheme, 2019. The Assessing Officer completed the assessment vide Assessment Order, dated 28/01/2021, passed under Section 143(3) read with Section 143(3A)/(3B) of the Act accepting the returned income as the

assessed income without making any additions/disallowances.

3.1. Subsequently, the PCIT, exercising the powers of revision under Section 263 of the Act, set aside the Assessment Order, dated 28/01/2021 holding the same to be erroneous in so far as prejudicial to the interest of the Revenue by invoking provision of Explanation 2 to Section 263(1) of the Act.

3.2. Being aggrieved, the Assessee has preferred the present appeal before the Tribunal on the grounds reproduced in paragraph 2 above. Since all the grounds are directed against the order of revision passed by the PCIT under Section 263 of the Act the same are being taken up together herein under.

4. We have heard both the sides and considered the rival submissions. On perusal of record, it emerges that there is no dispute as to the fact that the Appellant had claimed deduction for amortized Employee Stock Option Plan (ESOP) expenses of INR 73,55,180/-. On examination of the Assessment records, the PCIT formed a view that the aforesaid expenses were not allowable as deduction under Section 37(1) of the Act. According to the PCIT the Assessing Officer failed to conduct proper inquiry/verification into this aspect, and therefore, the Assessment Order was rendered erroneous in so far as prejudicial to the interest of the Revenue in terms of Section 263 read with Explanation 2 to 263(1) of the Act. The relevant extract of the order passed by the PCIT dealing with the issuance of notice under Section 263(1) and the findings given by the PCIT read as under:

> *"2 Subsequently, the assessment records of the relevant assessment year were called for and examined. On examination of the case records, it was noticed that the assessee company has debited in the profit and loss account an amount of Rs. 73,55,180/- on account of Employee Stock*

Option Plan (ESOP). This amount was debited u/s 37 of the Act. However, this amount of debit is prima facies not an allowable expense u/s 37(1) of the Act. When a company grants benefits to its employees by way of allotment of shares under ESOP at a concessional rate, it does not part with any money or asset nor does it incur any liability. Therefore, as per the ratio of the Hon'ble Supreme Court judgment in the case of Indian Molasses Company Ltd., the company cannot be said to have incurred any expenditure by providing the said benefit to the employees and as such the value of the benefit cannot be allowed as a deduction under the provisions of section 37 of the Act. Accordingly, the assessee was issued a notice u/s 263 of the Act on 03.03.2023. The contents of the notice are as under:

> *"On perusal of the case records, it is noticed that you had debited Rs. 73,55,180/- in P & L a/c on account of ESOP. The same is not allowable deduction as the debit of the amount of the employee compensation expense to the profit and loss account is merely an appropriation of profits towards a reserve called 'Share Premium Account'.* ***Since this amount remains a part of the funds of the company, it cannot be said to be an expenditure for the purpose of allowance u/s 37 of the Act. The ratio of Supreme Court decision in the case of Molasses Co.(P) Ltd. is applicable in this case****.*

In view of the aforesaid reasons, it is proposed to revise the assessment order dtd. 28.01.2021 under section 263 of the Income-tax Act, 1961, being erroneous in so far as it is prejudicial to the interest of revenue since it has been made ***without proper enquiries & verification*** *which should have been made.*

You are hereby given an opportunity to represent your case as to why the proposed action u/s 263 be not pursued an necessary order be passed on the issues discussed above as well as other issues that may come to the notice of the undersigned during this proceedings.

3. xx xx

4. The detailed submission of the assessee has been duly considered. ***It is seen that there are judgements on this***

issue which are in favour of the assessee as well as against the assessee. *In the case of Ranbaxy Laboratories Ltd. [2010] 39 SOT 17 (Delhi) (URO) it was held that what was loss to the assessee was by way of short receipt of share premium account and not by way of any expenditure or incurring any liability for such an expenditure. By issuing shares at below market price, the same did not result into incurring any expenditure, rather it resulted into short receipt of share premium which the assessee was otherwise entitled to. The assessee was not to defray or pay any liability under the claim. Therefore, such notional loss could not be held to be allowable under the scheme of the Act. As regards the claim of the assessee under section 37, since the assessee had not incurred any expenditure but had merely received lesser amount of share premium, it was held that the same did not amount to expenditure within the meaning of section 37 and that therefore, the claim of the assessee was not allowable. Thus, since this amount remains a part of the funds of the company, it cannot be said to be expenditure for the purpose of allowance u/s 37 of the Income Tax Act, 1961. In view of the above discussion, therefore, the above expenditure debited by the assessee amounting to Rs. 73,55,180/- during the year is not allowable as business expenditure u/s 37 of the Act.*

5. ***However, it is also seen that the issue of Employees Stock Option Plan is pending before the Hon'ble Supreme Court in the case of M/s Biocon Ltd. vide Diary No. 14965 of 2021. Thus, it is seen that the issue of ESOP is subjudice in the highest court of land and not settled***.

6. *In view of the legal position and the facts discussed above,* ***the Assessing Officer's failure in not examining the impugned issue by way of enquiries/verification that were required in this case****, has rendered the assessment order dtd. 28.01.2021 erroneous in so far as, it is a 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 dtd. 28.01.2021 passed by the Assessing Officer u/s 143(3) r.w.s. 143(3A) & 143(3B) 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." (Emphasis Supplied)

4.1. On perusal of the above, it emerges that the PCIT formed a view that the order passed by the Assessing Officer was erroneous in so far as it is prejudicial to the interest of Revenue by placing reliance on the judgment of the Hon'ble Supreme Court in the case of Indian Molasses Co. (P.) Ltd. v. CIT [1959] 37 ITR 66 (SC) and the decision of the Delhi Bench of the Tribunal in the case of Ranbaxy Laboratories Ltd. Vs. Additional Commissioner of Income Tax: [2010] 39 SOT 17 (Delhi) (URO) without appreciating that both the aforesaid decisions were considered by the Special Bench of the Tribunal in the case of Biocon Ltd. Vs. Deputy Commissioner of Income Tax – LTU, Bangalore: 2013] 35 taxmann.com 335 (Bangalore - Trib.) (SB)/[2013] 25 ITR(T) 602 (Bangalore - Trib.) (SB) while holding that the deduction under Section 37(1) of the Act is allowable for ESOP expenses. The relevant extract of the decision of Special Bench of the Tribunal reads as under:

8. We will take up these three steps one by one for consideration and decision.

I. WHETHER ANY DEDUCTION OF SUCH DISCOUNT IS ALLOWABLE ?

9.1 The crux of the arguments put forth by the ld. AR is that discount under ESOP is nothing but employees cost incurred by the assessee for which deduction is warranted. On the other hand, the Revenue has set up a case that no deduction can be allowed as such discount is not only a short capital receipt but also a contingent liability.

A. Is discount under ESOP a short capital receipt?

9.2.1The ld. DR stated that the question of deduction u/s 37 can arise only if the assessee incurs any expenditure, which thereafter satisfies the requisite conditions of the sub-section (1). <u>He submitted that the word "expenditure" has been described by the Hon'ble Supreme Court in the case of Indian</u>

Molasses Co. (P.) Ltd. v. CIT [1959] 37 ITR 66 as denoting spending or paying out, i.e. something going out of the coffers of the assessee. It was put forth that by issuing shares at discounted premium, nothing is paid out by the company. Once there is no "paying out or away", the same cannot constitute an expenditure and resultantly section 37(1), which applies to only expenditure, cannot be activated. He further took pains in explaining that there is no revenue expenditure involved in the transaction of issuance of ESOP at discount. The so called 'discount' represents the difference between market price of the shares at the time of grant of options and the price at which such options are granted. Since the amount over and above the face value of the shares, being the share premium, is itself a capital receipt, any under-recovery of such share premium on account of obligation to issue shares to employees in future at a lower premium, would be a case of short capital receipt. If at all it is to be viewed in terms of expenditure, then, at best, it would be in the nature of a capital expenditure. He supported his view by relying on the order passed by the Delhi Bench of the Tribunal in Ranbaxy Laboratories Ltd. v. Addl. CIT [2010] 39 SOT 17 (URO). It was stated that the Tribunal in that case has held that since the receipt of share premium is not taxable, any short receipt of such premium on issuing options to employees will be notional loss and not actual loss for which any liability is incurred. The learned Departmental Representative contended that the Mumbai bench of the Tribunal in the case of VIP Industries v. Dy. CIT [IT Appeal No.7242 (Mum.) of 2008 has also taken similar view vide its order dated 17.09.2010.]

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9.2.7 Now we espouse the second part of the submission of the ld. DR in this regard. He canvassed a view that an expenditure denotes "paying out or away" and unless the money goes out from the assessee, there can be no expenditure so as to qualify for deduction u/s 37. Sub-section (1) of the section provides that any expenditure (not being expenditure in 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". To put it differently, an expenditure must be laid out or expended wholly and exclusively for the purpose of business so as to be eligible for deduction u/s 37(1). There is absolutely no doubt that section 37(1) talks of granting deduction for an 'expenditure', and the Hon'ble Supreme Court in Indian Molasses Co. (P.) Ltd. (supra) has described 'expenditure' to mean what is 'paid out or away' and is

something which has gone irretrievably. However, it is pertinent to note that this section does not restrict paying out of expenditure in cash alone. Section 43 contains the definition of certain terms relevant to income from profits of business or profession covering sections 28 to 41. Section 37 obviously falls under Chapter IV-D. Sub-section (2) of section 43 defines "paid" to mean: "actually paid or incurred according to the method of accounting upon the basis of which the profits or gains are computed under the head 'profits and gains of business or profession'." When we read the definition of the word "paid" u/s 43(2) in juxtaposition to section 37(1), the position which emerges is that it is not only paying of expenditure but also incurring of the expenditure which entails deduction u/s 37(1) subject to the fulfilment of other conditions. At this juncture, it is imperative to note that the word 'expenditure' has not been defined in the Act. However, sec. 2(h) of the Expenditure Act, 1957 defines 'expenditure' as : 'Any sum of money or money's worth spent or disbursed or for the spending or disbursing of which a liability has been incurred by an assessee……'. When section 43(2) of the Act is read in conjunction with section 37(1), the meaning of the term 'expenditure' turns out to be the same as is there in the afore quoted part of the definition under section 2(h) of the Expenditure Act, 1957, viz., not only 'paying out' but also 'incurring'. Coming back to our context, it is seen that by undertaking to issue shares at discounted premium, the company does not pay anything to its employees but incurs obligation of issuing shares at a discounted price on a future date in lieu of their services, which is nothing but an expenditure u/s 37(1) of the Act.

9.2.8 Though discount on premium is nothing but an expenditure u/s 37(1), it is worth noting that the Hon'ble Supreme Court in the case of CIT v. Woodward Governor India (P.) Ltd. [2009] 312 ITR 254/179 Taxman 326 has gone to the extent of covering "loss" in certain circumstances within the purview of "expenditure" as used in section in 37(1). In that case, the assessee incurred additional liability due to exchange rate fluctuation on a revenue account. The Assessing Officer did not allow deduction u/s 37. When the matter finally reached the Hon'ble Supreme Court, their Lordships noticed that the word "expenditure" has not been defined in the Act. They held that : "the word "expenditure" is, therefore, required to be understood in the context in which it is used. Section 37 enjoins that any expenditure not being expenditure of the nature described in sections 30 to 36 laid out or expended wholly and exclusively for the purposes of the business should be allowed in computing the income chargeable under the head "profits and gains of business or profession". In sections 30 to 36 the expression "expenditure incurred", as well as allowance and depreciation,

has also been used. For example depreciation and allowances are dealt with in section 32, therefore, the parliament has used expression "any expenditure" in section 37 to cover both. Therefore, the expression "expenditure" as used in section 37 made in the circumstances of a particular case, covers an amount which is really a "loss" even though the said amount has not gone out from the pocket of the assessee'. From the above enunciation of law by the Hon'ble Summit Court, there remains no doubt whatsoever that the term 'expenditure' in certain circumstances can also encompass 'loss' even though no amount is actually paid out. Ex consequenti, the alternative argument of the ld. DR that discount on shares is 'loss' and hence can't be covered u/s 37(1), also does not hold water in the light of the above judgment. In view of the above discussion, we, with utmost respect, are unable to concur with the view taken in Ranbaxy Laboratories Ltd. (supra)."(Emphasis Supplied)

4.2. On perusal of the above it becomes clear that the reasoning given by the Ld. PCIT for forming the view that the deduction for ESOP Expenses was not allowable under Section 37(1) of the Act stands rejected by the Special Bench of the Tribunal. Further, In the case of DCIT Vs. Kotak Mahindra Bank Ltd.: 89 taxmann.com 223, relied upon by the Ld. Authorised Representative for the Appellant during the course of hearing, the Mumbai Bench of the Tribunal had made following observations while dismissing the appeal preferred by the Revenue against the order passed by CIT(A) deleting the addition of ESOP expenses made by the Assessing Officer in that case:

"8. We find that the A.O while framing the assessment had specifically observed that the claim of the assessee towards entitlement of discounted premium on ESOP's as an expenditure under sec. 37(1) was though found to be in accordance with the principle laid down by the 'Special Bench' of the Tribunal in the case of Biocon Ltd. (supra), however, as the order of the 'Special Bench' of the Tribunal had not been accepted by the department and had been assailed before the Hon'ble High Court of Karnataka, therefore, the claim of the assessee as regards allowability of discounts on ESOP's could not be accepted. We are unable to persuade ourselves to subscribe to the aforesaid view of the A.O that the order of the 'Special Bench' of the Tribunal was not to be followed for the reason that an appeal had been filed by the department against the said order before the Hon'ble High Court of

Karnataka. We find that it is not the case of the department that either the order of the 'Special Bench' of the Tribunal in the case of Biocon Ltd. (supra) had been set aside or the operation of the same had been stayed by the Hon'ble High Court. We are unable to comprehend that as to how the A.O despite conceding that the claim of the assessee as regards allowability of the discount of ESOP's was in accordance with the principle laid down by the 'Special Bench' of the Tribunal in the case of Biocon Ltd. (supra), could still decline to adjudicate the issue under consideration in terms with the order of the 'Special Bench'. We are seriously taken aback by the aforesaid observations of the A.O, and are of a strong conviction that as on the date on which the assessment was framed, the order of the 'Special Bench' of the Tribunal did hold the ground, therefore, he remained under a statutory obligation to have passed his order in conformity with the view taken by the 'Special Bench', which we find had also been followed by the jurisdictional Tribunal, viz. ITAT, Mumbai in the case of Mahindra and Mahindra Ltd. (supra). We are afraid that the conduct of the A.O in declining to follow the order of the 'Special Bench' of the Tribunal in the case of Biocon Ltd. (supra), which as observed by us had neither been set aside or stayed by the Hon'ble High Court has to be deprecated. We find that the Ld. CIT (A) duly appreciating the serious infirmity in the order of the A.O, therein going by the principle of judicial discipline had set aside the order of the A.O by observing that the issue under consideration was covered by the order of the 'Special Bench' of the Tribunal in the case of Biocon Ltd. (supra). We find that the department had assailed the order of the CIT (A) before us for the reason that the latter had erred in directing the A.O to follow the order of the 'Special Bench' of the Tribunal in the case of Biocon Ltd. (supra). We would not hesitate to observe that it is absolutely beyond our comprehension that as to how the department could be aggrieved with the order of the Ld. CIT (A) who had set aside the observations of the A.O which were palpably found to be in serious contradiction of the order of the 'Special Bench' of the Tribunal in the case of Biocon Ltd. (supra). We may herein clarify that neither anything has been placed on record nor averred before us which could persuade us to conclude that the order of the 'Special Bench' of the Tribunal in the case of Biocon Ltd. (supra) had either been stayed or set aside by the Hon'ble High Court of Karnataka, or a view taken by the 'Special Bench' no more holds the ground on account of a contrary view taken by any other High Court. We thus in the backdrop of our aforesaid observations are unable to persuade ourselves to accept the ground of appeal raised by the revenue before us, therefore, finding no infirmity in the well reasoned order of the CIT (A), uphold the same.

9. The appeal of the revenue is dismissed in terms of our aforesaid observations."

4.3. In view of the above decision of the Tribunal, we hold that the order passed by the Assessing Officer cannot be regarded as erroneous or prejudicial to the interest of the Revenue. Further, in any case, it cannot be denied that the view taken by the Assessing Officer was a plausible view and therefore, the Ld. PCIT would not be justified in exercising powers of revision under Section 263 of the Act. We also note that the Ld. PCIT was cognizant of the fact that the decision of the Special Bench of the Tribunal in the case of Biocon Limited (supra) has been confirmed by the Hon'ble High Court of Karnataka vide judgment dated 11/11/2020 passed in IT Appeal No. 653 Of 2013 reported in [2020] 121 taxmann.com 351 (Karnataka)/[2021]; and the issue is now pending the Hon'ble Supreme Court. Despite that, the Ld. PCIT had, possibly to keep the issue alive, exercised the powers of revision under Section 263 of the Act by invoking provision of Explanation 2 to Section 263(1) of the Act to contend that the claim for ESOP expenses has been allowed without proper enquiry/verification by the Assessing Officer. In this regard, we note that, firstly, all the relevant facts were already on record and therefore, the question of further enquiry/verification did not arise. Secondly, on perusal of contents of the notice under Section 263(1) of the Act, as reproduced in paragraph 2 of the order impugned, we find that the Ld. PCIT had issued notice under Section 263(1) of the Act on forming a view that proper inquiry/verification as warranted in the facts and circumstances of the case - which falls within the ambit of Explanation 2(a) to Section 263(1) of the Act, was not conducted. Therefore, in our view, the Assessment Order cannot be set aside on the ground that the same has been passed allowing deduction under Section 37(1) of the Act without inquiring into the claim - which falls within the ambit of Explanation 2(b) to Section 263(1) of

the Act without confronting the Appellant. For this reason also the order passed by the Ld. PCIT cannot be sustained.

4.4. In view of the above, the order, dated 17/03/2023, passed by the Ld. PCIT is under Section 263 of the Act is set aside and the Assessment Order, dated 28/01/2021, passed under Section 143(3) read with Sections 143(3A) & 143(3B) of the Act is reinstated.

5. In result, the present appeal preferred by the Assessee is allowed.

6. Order pronounced on 31.07.2023.

Sd/-	***Sd/-***
(Om Prakash Kant)	**(Rahul Chaudhary)**
Accountant Member	**Judicial Member**

मुंबई Mumbai; दिनांक Dated : 31.07.2023
Alindra, PS

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

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. आयकर आयुक्त/ The CIT
4. प्रधान आयकर आयुक्त / Pr.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