

**IN THE INCOME TAX APPELLATE TRIBUNAL  
'B' BENCH : BANGALORE**

**BEFORE SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER  
AND  
SMT. BEENA PILLAI, JUDICIAL MEMBER**

<b>ITA No. 817/Bang/2023</b>
<b>Assessment Year : 2018-19</b>

M/s. Microchip Technology (India) Pvt. Ltd., No. 149B EPIP Industrial Area, First Phase Whitefield, Bangalore – 560 066. <b>PAN: AABCM9868J</b>	<b>Vs.</b>	The Deputy Commissioner of Income Tax, Circle – 4(1)(1), Bangalore.
<b>APPELLANT</b>		<b>RESPONDENT</b>

Assessee by	:	Shri Sumeet Khurana, CA
Revenue by	:	Shri Biju M.K., CIT-DR

Date of Hearing	:	18-04-2024
Date of Pronouncement	:	16-05-2024

**ORDER**

**PER BEENA PILLAI, JUDICIAL MEMBER**

Present appeal arises out of order dated 28.08.2023 passed by NFAC, Delhi for A.Y. 2018-19 on following grounds of appeal:

*“The grounds mentioned herein by the Appellant are without prejudice to one another.*

*1. On the facts and in circumstances of the case and in law, the Appellate order issued under section 25o of the Income-tax Act, 1961 (‘the Act’) passed by the*

*Commissioner of Income-tax (Appeals), NFAC. (learned CIT(A)) dated 28 August 2023, to the extent prejudicial to the Appellant, is bad in law, void ab initio and contrary to the facts and circumstances of the case and is liable to be quashed.*

*2. On the facts and in the circumstances of the case and in law, learned AO erred in not quoting a valid computer-generated DIN on the body of draft assessment order dated 20 September 2021, in contravention to the Circular No. 19 of 2019 by the CBDT, thus rendering such an order to be invalid and never to have been issued as per para 4 of the said order, resultantly the final assessment order dated 27 September 2021 passed by learned AO under section 143(3) r.w.s. 144B of the Act pursuant to invalid and non-est draft assessment order, is bad in law, null and void and liable to be quashed.*

*3. On the facts and in the circumstances of the case and in law, the learned CIT(A) and learned AO ought to have appreciated that the ESOP issue is decided in favour of the Appellant by the Income Tax Appellate Tribunal for AY 2009-10 and followed the same.*

*4. On the facts and in the circumstances of the case and in law, the learned CYI(A) and learned AO erred in not considering the submission made by the Appellant while disallowing ESOP expense under section 37 of the Act and by doing so erroneously held that:*

*(a) Genuineness of expense has not been examined and not proved:*

*(b) The Appellant has not submitted the supporting evidence as the above expenses incurred wholly and exclusively for the business purposes:*

*(c) ESOP are not in the nature of employee cost:*

*(d) Expenditure is not allowable in the year under consideration:*

*(e) Expense is too high for creating a capital base of Microchip Technology Inc. US by way of increase in share capital and hence, the same is not allowable as revenue expenditure.*

*5. On the facts and circumstances of the case and in law, the learned CIT(A) and learned AO erred in not considering Appellant's submission while making adhoc disallowance of 10% of the expense incurred under the head 'miscellaneous expense' and 'staff welfare expense under section 37 of the Act.*

*6. On the facts and in the circumstances of the case and in law, the learned AO has erred in initiating penalty proceedings under section 270A of the Act.*

*That the Appellant craves leave to add to and/or to alter, amend, rescind, modify the grounds herein below or produce further documents before or at the time of hearing of this Appeal.”*

## **2. Brief facts of the case are as under:**

**2.1** Assessee is a company engaged in the business of rendering software engineering application and development services to Microchip Technology Inc., USA and its subsidiaries. It also provides marketing support services for the products manufactured by the parent company being Microchip Technology Inc.

**2.2** For the year under consideration, assessee filed its return of income on 30.11.2018 declaring total income of Rs.51,34,90,850/-. The return was selected for scrutiny and notices u/s. 143(2) r.w.s. 142(1) of the act was issued to assessee. In response to the statutory notices, representative of assessee appeared before the Ld.AO and filed the details as called for. The Ld.AO noted that assessee had international transaction with its associated enterprise and accordingly a reference was made to the transfer pricing officer to compute the arms length price. On receipt of the reference u/s. 92CA(1), the transfer pricing officer carried out transfer pricing assessment and vide order dated 27.07.2021 passed the order u/s. 92CA(3) with no adverse inference in respect of the international transactions entered into between the assessee and the associated enterprises.

On receipt of the transfer pricing order, the Ld.AO issued 142(1) notice on 27/08/21 to verify the ESOP expenses claimed by the assessee amounting to Rs.9,90,81,453/- on payment basis u/s. 37 of the act. The assessee vide correspondence dated 09.09.2021 submitted details, but was silent on the issue. The Ld.AO recorded that the assessee did not file any supporting evidence in respect of ESOP expenses paid during the year under consideration.

Thereafter, another notice was issued on 20.09.2021 with the proposal to disallow the ESOP expenses claimed by the assessee on payment basis, u/s. 37 of the act. The assessee thereafter furnished various details in respect of the amount that was claimed as expenses towards the ESOP on restricted stock units (RSU's) granted to the employees of the assessee by its parent company who is the ultimate holding company.

**2.3** The assessee submitted that it claimed following amounts with respect to ESOP for the year under consideration;

<i>Particulars</i>	<i>Amount (in INR)</i>
<i>ESOP expenses pertaining to the earlier financial years paid during the FY 2017-18 claimed on payment basis</i>	9,96,81,453
<i>ESOP expenses debited to the statement of profit and loss for FY 2017-18 claimed on accrual basis</i>	36,98,28,659
<i>Total</i>	46,95,10,112

**2.4** The assessee submitted that during the year under consideration, the Company debited an amount of INR

36,98,28,659 on account of cross charge of expenditure on Restricted Stock Units (RSU's)/Employee Stock Purchase Plan ("ESPP's") granted to the employees of the assessee by its parent company being Microchip Technology Inc. (hereinafter referred to as "MTI") on accrual basis. The assessee submitted that, the shares of MTI were listed on the stock exchange in the United States of America. A proof of the listing of MTI's shares was filed before the Ld.AO for reference. It was submitted that the assessee follows the Microchip Technology Inc Equity Incentive Plan, 2004 (being the ESOP Plan) for the share-based compensation to be provided to assessee's employees. The ESOP scheme was also filed before the Ld.AO for reference.

**2.5** It was submitted that as part of ESOP Plan, selected employees the assessee were granted RSU's/ESPP's of MTI during the course of employment. These RSU/ESPP's were provided to assessee's employees for the purpose of attracting and retaining the best available personnel and providing additional incentives to eventually promote the success of the Company's business.

**2.6** The assessee thus submitted that, in preceding years the assessee used to disallow the expenses debited to the statement of profit & Loss account on accrual basis and claimed deduction only to the extent of actual payments reimbursed to MTI during the particular year. The assessee thus submitted that for A.Ys. 2011-12 to 2017-18, assessee consistently claimed the deduction u/s. 37 in the year in which the amount would be cross charged

by the parent company i.e. the assessee claimed deduction on actual payment of expenses to the parent company. It is submitted that the said approach was upheld by the decisions of *Coordinate Bench of this Tribunal* in assessee's own case for AY 2009-10.

**2.7.** The assessee, submitted that, for the year under consideration, it was submitted that, the assessee revisited the position of deductibility of such expenses and claimed the expenses based on accrual principle also. Further, it was submitted that, the assessee claimed deduction of amounts reimbursed to the parent company pertaining to the earlier year, wherein the expenses were disallowed on accrual basis to avoid double taxation. Such treatment of accounting by the assessee was not accepted by the Ld.AO and disallowed the claim of assessee made on payment basis by observing as under:

*“5.5. The submission of the assessee has been carefully considered with facts of the case and provision of the Act. The assessee company has quoted the various decision on various issued which is duly considered but not relevant to the facts of the case. The assessee has failed to submit the relevant details as called vide notice u/s 142(1) and put up the addition by way of draft assessment order in respect of ESOP expenses at Rs.9,90,81,453/- as allowable expenditure u/s 37 of the IT Act discussed as under:-*

*(i) The assessee has not submitted the break-up and working of ESOP expenses with their copy of ledger account, hence the genuineness of expenses has not been examined and not proved.*

*(ii) The assessee has claimed that discount under ESOP of Rs. 36,98.28,659/- is in the nature of employees cost and reimbursed to parent company but ESOP expenses of Rs.9,90,81.453/- is not related to the nature of employees cost but it is in relation to expenses on account of ESOP Scheme issued by the assessee company.*

(iii) Further, it is observed that the ESOP expenses of Rs.9,90,81,453/- pertaining to the earlier financial years paid during the FY 2017-18 and claimed on payment basis which is not allowable u/s 37(1) as the above expenses is the prior period expenses and assessee has followed the mercantile system of accounting. As per the Companies Act, 2013 every company has to follow a mercantile system of accounting. and all income and expenses will be booked based upon the accrual concept of accounting. Once a company record an expenditure it is no longer remains contingent. The liability of ESOP will be accounted.

(iv) It is noted that the parent company Microchip Technology Inc. ("MTI") i.e., its ultimate holding company had issued employee stock options (ESOP) to certain employees of the assessee Company and had been cross charged for the year ended March 31. 2017 towards the ESOP expenses of Rs.9,90,81,453/-. Therefore. it is stated that this amount of Rs. Rs.9,90,81,453/- to be disallowable for the reason that it was a prior period expenditure. As the above expenditure had crystallized in the preceding years therefore, it should not be allowed in the present year.

(v) It is noted that this amount of Employee stock option scheme of Rs. 36,98,28,659/- and prior period expenditure towards the ESOP expenses of Rs.9,90,81,453/- totaling to Rs. 46,95,10,112/- claimed by the assessee as revenue expenditure u/s 37(1) of the Act. Further, it is observed that expenses incurred in relation to ESOP is too high nearby 27% not justifiable in the absence of requisite details. Moreover, the expenses of Rs. 9,90,81,453/- is the expenditure incurred for creating the capital base of Microchip Technology Inc. ("MTI") i.e., its ultimate holding company by way of increase the share capital, hence the same is not allowable as revenue expenditure but it distributed of profit come in purview of dividend paid to Microchip Technology Inc. ("MTI") i.e., its ultimate holding company.

(vi) The ESOP expense even if treated as expenditure is a capital expenditure since securities premium being a capital item.

Whereas the Delhi ITAT in the case of ACTT Vs Raiihaxy Laboratories ITA No 2613 & 3871 has held that the ESOP expense debited to P&L is notional in nature since the assessee has neither laid out or expended any

*amount while choosing to receive no/ lesser securities premium. The alternative argument that this ITAT has supported is since the receipt of securities premium is not chargeable to tax being a capital receipt any short collection of securities premium should also be considered as capital outlay and cannot be allowed as expenditure.*

*(vii) Further. the assessee Company submits that it is in the process of collating the documents pertaining to the workings of ESOP expenses and the other documents requested in point 9 of the notice and requests your goodself to grant an adjournment of 7 days. The submission of the assessee has been considered but due to matter is time barred on 30.09.2021, further time is not granted to the assessee. Moreover the assessee has given sufficient time on this issue beginning from 30/08/2021 vide notice issued u/s 142(1) to till date of assessment order.*

*5.6. Keeping in view of the above facts, the ESOP expenses to the extent of Rs. 9,90,81,453/- paid to Microchip Technology Inc. is not considered as revenue expenditure as it is not issued as employee stock options (ESOP) to certain employees of the assessee Company. Further, the assessee has also not submitted the supporting evidence as the above expenses incurred wholly and exclusively for the business purposes. In view of the above, the ESOP expenses to the extent of Rs. 9,90,81,453/- is hereby disallowed u/s 37(1) of the Act. But it distributed of profit come in purview of dividend paid to Microchip Technology Inc. ("MTI") i.e., its ultimate holding company."*

**2.8** Aggrieved by the order of the Ld.AO, assessee preferred appeal before the Ld.CIT(A). The Ld.CIT(A) after considering the submissions of assessee observed and held as under:

*"6.6 In response to this, the assessee was silent on this issue and not submitted the supporting evidence in support of ESOP expenses of Rs.9,90,81,453/- as allowable expenditure u/s 37 of the IT Act. The assessee has not submitted the break-up and working of ESOP expenses with their copy of ledger account, hence the genuineness of expenses has not been examined and not proved. Further, the assessee has also not submitted the supporting evidence as the above expenses incurred wholly and exclusively for the business purposes.*

*6.7 Hence, in view of the above and on the basis of the detailed findings and reasons given by the AO in his assessment order, the addition made by the Assessing Officer amounting to Rs 9,90,81,453/- as ESOP expenses u/s 37(1) of the IT Act is hereby confirmed and Ground Nos. 2 to 4 are dismissed.”*

**2.9** Aggrieved by the order of the Ld.CIT(A), assessee is in appeal before this *Tribunal*.

**3. Ground no. 1** is general in nature and therefore do not require any adjudication.

**4.** Before us the Ld.AR has not referred to **Ground no. 2** and has not submitted any written submission in respect of the same. Accordingly, this ground is treated as not pressed and dismissed.

**5. Ground nos. 3-4** are in respect of disallowance of ESOP expenses claimed by assessee on payment basis to the parent company.

**5.1** The Ld.AR submitted that, the authorities below dismissed the claim of assessee erroneously by holding that, the genuineness of the expenses claimed by the assessee under ESOP was not proved, and therefore is not examined. The LD.AR submitted that, it is wrongly noted by the authorities below, that the assessee did not submit any supporting evidences in respect of the expenses claimed. The Ld.AR submitted that the assessee filed the ESOP plan of the parent company, the proof of listing of the parent company on US stock exchange. Before both the authorities below, the Ld.AR also submitted that the assessee

decided to claim the deduction on accrual basis for the year under consideration for the first time. He submitted that, the year under consideration is the transition period, and the assessee claimed expenses on payment basis (the expenses accrued on past previous year and was not claimed as deduction while computing total income) and also on accrual basis.

**5.1.1** He submitted that the Ld.AO allowed the claim of expenditure on accrual basis and disallowed the claim raised by assessee on payment basis. The Ld.AR placed reliance on assessee's own case for A.Y. 2009-10 in *IT(TP)A Nos. 276 & 187/Bang/2014* vide order dated 28/08/2019. The Ld.AR submitted that identical issue was considered by this *Tribunal* by allowing the claim on payment basis.

**5.2.** The Ld.AR submitted that there was no change in the rate of tax from Assessment Years 2015-16 to 2018-19 and the revenue has not lost any tax on the method of ESOP deduction claimed by assessee during the year under consideration. The Ld.AR further submitted that the observations of the Ld.AO/NFAC are incorrect for the following reasons:

S.No.	AO's contention confirmed by the NFAC	Appellant's rebuttal
1.	Genuineness of expense has not been examined and not proved	<p>The Appellant has submitted following documents to prove the genuineness of expense-</p> <p>a. ESOP plan to give a background of nature of expense (Refer page 106 to 123 of the paper book).</p> <p>b. Debit note issued by Microchip Technology Inc, proof of payment and list of employees to whom ESOP has been allotted to demonstrate that there has been an actual outflow of cash. (Refer page 131 to 167 of the paper book).</p> <p>c. Sample Form 16 to demonstrate that the said forms part of employee cost on which the Appellant has deducted tax at source (Refer page 125 to 130 of the paper book)</p>
2.	The Appellant has not submitted the supporting evidence as the above expenses incurred wholly and exclusively for the business purposes	<p>In addition to above, the Appellant submits that 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 service that contributes to the growth of company. Therefore, the said expense is wholly and exclusively for the purpose of business. In this regard reliance is placed on</p> <p>(a) Novo Nordisk India (P.) Ltd. V. DCIT [2014] 42 taxmann.com 168 (Bangalore -Trib.)- para 23 and 24 at page 32 of the case law compendium.</p> <p>(b) Global E-business Operations (P.) Ltd. [2023] 153 taxmann.com 521 (Bangalore-Trib.) followed Novo Nordisk (supra)- para 9 at page 66 and 73 of the case law compendium.</p>
3.	ESOP are not in the nature of employee cost	As submitted in S.no. 1, the Appellant has submitted sample Form 16 of an employee to demonstrate that the said expense is employee cost on which the Appellant has deducted tax at source (Refer page 125 to 130 of the paper book).

4.	Expense is too high for creating a capital base of Microchip Technology Inc. US by way of increase in share capital and hence, the same is not allowable as revenue expenditure.	<p>The Appellant submits that the expenditure is revenue in nature and in this regard wishes to place reliance on-</p> <p>(a) Biocon Ltd. [2020] 121 <a href="http://taxmann.com">taxmann.com</a> 351 (Karnataka)- Para m page 84 and Biocon Ltd. [2013] 35 <a href="http://taxmann.com">taxmann.com</a> 335 (Bangalore-Trib.)- Para 9.2.6 at page 95 of the case law compendium.</p> <p>(b) Novo Nordisk (supra) -Para 18 at page 31 and 24 at 32</p> <p>(c) Cerner Healthcare Solutions India (P.) Ltd. [2022] 141 <a href="http://taxmann.com">taxmann.com</a> 564 (Bangalore-Trib.)- para 9 and lo at page 112 &amp; 113 of the case law compendium.</p> <p>(d) Global E-business Operations (P.) Ltd. (supra) - para 9 at page 65 to 73 of the case law compendium.</p>
5.	Expenditure is not allowable in the year under consideration	<p>As submitted vide para 17, the year of deduction is not detrimental to the revenue.</p> <p>Further, in case the disallowance is being upheld the appellant will end up paying higher tax as the appellant has not claimed the impugned expense on accrual basis. Computation of Income of past previous year is placed at page 168 to 173 of the paper book.</p>

**5.3** On the contrary, the Ld.DR submitted that the Ld.AO has allowed the claim of assessee u/s.37 of the act that was debited to the statement of profit and loss account on accrual basis. He submitted that the Ld.AO disallowed the claimed relating to ESOP as the assessee failed to submit the breakup and working of the expenses. The Ld.DR submitted that disallowance is made for the reason that the expenditure was relating to prior period. The Ld.DR submitted that the expenditure had crystallised in the preceding year and therefore it cannot be allowed in the year under consideration.

**5.4** The Ld.DR also submitted that the portion of the expenses that was disallowed by the Ld.AO is the expenses that is not incurred by the assessee during the year under consideration. He

submitted that assessee did not file all relevant details in order to carry out necessary verification in respect of the same by the Ld.AO. He thus submitted that due to lack of evidences, all these verification has not been carried out and therefore the disallowance is justified. The Ld.DR also filed following written submissions to support the argument of Revenue:-

*“With respect to the above-mentioned appeal the written submission of the Revenue is humbly submitted as below:*

*The matter in dispute before the Hon'ble Bench is whether the appellant can claim the deduction for ESOP expenditure to the tune of Rs.9,96,81,453/- on the payment basis. The amount of Rs.36,98,28,659/- was allowed as ESOP expenditure by the Assessing Officer, which was claimed on accrual basis. The appellant claims that the decision of this Hon'ble Bench in his own case IT(TP)A No.276 & 189(Bang)/2014 has decided that it has to be claimed on the payment basis. Two things, I would like to bring to the notice in this regard:*

*1) The ESOP expenditure has to be allowed only on accrual basis and it has been decided by jurisdictional High Court in the case of CIT v. Biocon Ltd. [2020] 121 taxmann.com 351 as well as it is a settled principle of law laid down by the Hon'ble Supreme Court in various decision and it has been very well considered by the Hon'ble High Court in the case CIT v. Biocon Ltd.*

*2) The appellant is claiming the ESOP payment basis as well as on accrual basis. This payment basis expenditure pertains to the earlier financial years. The appellant cannot give treatment of accrual and payment basis for claiming of the ESOP expenses at same time. It may also amount to following of dual accounting method in a FY. (i.e. cash method and accrual method).*

*3) If suppose the claim is made on payment basis then the statement of P&L A/c will also not depict the true and fair view.*

*The appellant cannot claim the excuse by relying on the decision of this Hon'ble Bench in IT(TP)A No.276 & 189(Bang)/2014 and seek the beneficence of the order, which does not hold good position of law. The Appellant should have agitated before the higher forum if the order passed was against the law of the land. Instead, he*

*sought to remain silent and use the decision in his favour to claim expenditure at point of time, when he thinks to claim ESOP expenses on payment basis. There is significant amount of difference in the profits of the Appellant due to claiming of expenses on payment basis. Also, the appellant has not shown the expenses of ESOP to the tune of Rs.9,96,81,453/- in his P&L account. The Note 17 of financial statements for the year ended March 31, 2018 is only showing the expenses on the employee stock compensation cost only Rs. 36,98,28,659/- and he is claiming the expenses which are not shown in the books of account, only in computation of income it is shown as "Excess ESOP expenses allowed on payment basis." Whereas the appellant has failed to show the exact Financial Year on which the expense of Rs. 9,96,81,453/- accrued.*

*For the state welfare expenses to the tune of Rs.7,49,44,494/- and Misc. Expenses of Rs. 3,44,65,841/- the assessee has not submitted the supporting evidence along with copy of ledger account and so the disallowance of Rs. 1,09,41,033/- (10% of Rs.10,94,10,335) and for this purpose I submit that matter is to be remitted back to the file AO and appellant has to give supporting evidences."*

**5.5** We have perused the submissions advanced by both sides in the light of records placed before us.

The parent company offered ESOP to assessee's employees to motivate them. The assessee reimburses to the parent company such ESOP discount offered to its employees. While ESOP expenses is held as a consideration for employment, the natural corollary that follows is;

- 1) Such discount is an expenditure;
- 2) Such expenditure is on account of ascertain (non-contingent liability) and
- 3) It cannot be treated as a short term capital receipt

**5.6** These has been analysed by various decisions of this *Tribunal* in case of

- a) *CIT vs. Biocon Ltd.* reported in (2013) 35 taxmann.com 335 (Bangalore Trib-SB)
- b) *CIT vs. Lemontree Hotels Pvt. Ltd.* reported in (2019) 104 taxmann.com 26 (Del)
- c) *M/s. Northern Operating Services Pvt. Ltd. vs. JCIT* reported in IT(TP)A No. 759/Bang/2017 vide order dated.....
- d) *Caterpillar India Pvt. Ltd. vs. DCIT* reported in (2017) 80 taxmann.com 325 (Chennai)
- e) *New Delhi Television vs. ACIT* reported in (2020) 117 taxmann.com 212
- f) *ACIT vs. People strong HR services Pvt. Ltd.* reported in (2022) 134 taxmann.com 351 (Delhi ITAT)

All the above decisions hold that a ESOP discount reimbursement by an Indian company to its parent foreign company will be an allowable deduction under section 37(1) of the Act.

**5.7** The provisions of section 37 of the act permits allowability of such expenditure only if;

- a) It is not an expenditure in the nature described u/s. 30 to 36 of the act
- b) It is not a capital expenditure
- c) It is not personal expenditure of the assessee
- d) It has been incurred in the previous year
- e) It is laid out or expended wholly and exclusively for the purposes of business.
- f) It is not been incurred for any purpose which is an offence or is prohibited by any law.

**5.8** The Ld.AR placed reliance on the decision of *Coordinate Bench of this Tribunal* in assessee's own case for A.Y. 2009-10 (supra). We note that for AY 2009-10, this *Tribunal* considered identical claim of the assessee under section 37(1) of the Act, as per accounting scheme in Note 8 to Schedule K of the financial statement reproduced as under:

*“The company has expensed to the Profit & Loss Account the cost of Stock Options and Restricted Stock Units granted to the employees of the Company by Microchip Technology Inc., the Company's holding company estimated at Rs.25,708,603/- (previous year Rs.15,522,724/-). The Company has also expensed to the Profit & Loss Account foreign exchange loss of Rs. 7,097,291/- (previous year foreign exchange gain of Rs. 1,778,871) on restatement of the foreign currency liability. A sum of Rs. 3,848,096/- (previous year Rs. 428,8311) has been remitted to the parent company and the balance of Rs.57,015,956/- (previous year Rs. 28,058,158/-) has been shown separately under Shareholders Funds. Pending receipt of necessary data from the parent company, the disclosures required to be given in terms of "Guidance Note on Accounting for Employee Share Based Payments" issued by Institute of Chartered Accountants of India have not been furnished.”*

The above note formed part of the submissions raised along with additional ground on this issue.

**5.8.1** From the above it is clear that the ESOP discount reimbursed by the assessee were based on the vesting of the relevant stock option/RSU's. This *Tribunal* allowed the claim of the assessee for A.Y. 2009-10 under section 37(1) of the Act, by following the observations of *Hon'ble Bangalore SB* in case of *CIT vs. Biocon Ltd. (supra)*:

*“11.3 We, therefore, sum up the position that the discount under ESOP is in the nature of employees cost and is*

*hence deductible during the vesting period w.r.t. the market price of shares at the time of grant of options to the employees. The amount of discount claimed as deduction during the vesting period is required to be reversed in relation to the unvesting/lapsing options at the appropriate time. However, an adjustment to the income is called for at the time of exercise of option by the amount of difference in the amount of discount calculated with reference the market price at the time of grant of option and the market price at the time of exercise of option. No accounting principle can be determinative in the matter of computation of total income under the Act. The question before the special bench is thus answered in affirmative by holding that discount on issue of Employee Stock Options is allowable as deduction in computing the income under the head 'Profits and gains of business or profession.'"*

**5.9** Coming to the circumstances in present appeal, it is noted that, the assessee claimed the ESOP cost on accrual basis also. Before the Ld.AO the assessee did not file any details regarding the payment made, except filing the ESOP scheme floated by the parent company. There is no reference to the invoices raised by the parent company in respect of the ESOP discount claimed by the assessee on payment basis. The Ld.AO has reproduced the submission by the assessee in the assessment order. Further from the reply filed by the assessee to the notice issued under section 142(1) of the act placed at page 52 - 72 of the paper book it is noted that the assessee made the claim as under:

Particulars	Amount (in INR)
<u>ESOP pertaining to the earlier financial years paid during the FY 2017-18 claimed on payment basis</u>	9,96,81,453
<u>ESOP expenses debited to the statement of profit and loss for FY 2017-18 claimed on accrual basis</u>	36,98,28, 659
Total	46,95,10,112

The Ld.AO allowed the claim of assessee on accrual basis without noting that the assessee consistently claimed the ESOP on cash basis, i.e; on actual payment to the parent company upon vesting of the stock option/RSU's (refer Note 8 reproduced hereinabove for A.Y. 2009-10).

**5.10** To understand the basis of the claim by assessee on both accrual and cash basis for the year under consideration, this *Tribunal* called upon the Ld.AR to file details of the claim made in respect of the cross charge by the assessee during preceding and subsequent years, to the year under consideration. The Ld.AR filed following chart as under:

Assessment Year	Amount debited to P&L A/c.	Amount claimed on cash basis in RoI	Amount claimed on accrual basis in RoI
2009-10	25,708,603	3,848,096	-
2010-11	30,084,265	19,991,401	-
2011-12	30,856,422	30,948,567	-
2012-13	37,233,471	20,619,494	-
2013-14	78,225,725	50,568,654	-
2014-15	112,288,721	159,758,753	-
2015-16	110,996,660	148,256,957	-
2016-17	100,121,382	167,121,733	-
2017-18	300,337,672	246,086,898	-
<b>2018-19</b>	369,828,659	99,681,453	369,828,659
2019-20	487,685,189	-	487,685,189
2020-21	481,887,444	-	481,887,444
2021-22	656,909,067	-	656,909,067
2022-23	681,496,183	-	681,496,183
2023-24	763,830,324	-	763,830,324

**5.11** From the table above it is clear that the assessee consistently followed cash system of accounting for the cross charge payment to the parent company on the ESOP discount. For the year under consideration, the assessee shifted to hybrid system of accounting, by submitting that, this year, is a transition period in respect of claim of ESOP discount and that the assessee claimed in the ROI on accrual basis as well as on payment basis. It is further noted that, from subsequent assessment year, nothing is claimed by the assessee on payment basis. The Ld.AR except for placing reliance on decisions of various courts in the PB filed on 31/01/2024, wherein hybrid system of accounting is upheld, no explanation is offered for such approach to be adopted for year under consideration. It is noted that, even the financial statement is silent on such change in method of accounting adopted for ESOP discount. Such approach is not acceptable, which is in violation of section 145 of the Act.

Section 145 of the Income Tax Act clearly mandates that the computation of income should be either cash or mercantile system of accounting regularly employed by the assessee and in accordance with sub-section (2) of Section 145 of the Income Tax Act. There is no bonafide reasons submitted by the assessee to follow hybrid system of accounting in the present assessment year for the purpose of ESOP discount reimbursed to the parent company. Needless to say that the assessee shall confine to cash system of accounting with respect to ESOP discounts and precluded from changing the system of accounting as followed by the assessee in the year under consideration.

**5.12** The authorities below has not verified the accounting system adopted by the assessee consistently in the past assessment years, keeping in view the mandate of provisions of section 145(2) of the Act. If the argument advanced by the Ld.AR is allowed it is not possible to ascertain the true profits for the year under consideration, which is the primary condition in accepting a particular method adopted by an assessee. We are therefore of the opinion that the issue needs to be verified in order to ascertain the correct position.

**5.13** We therefore remit the issue back to the Ld.AO to verify the claim *de novo*. We direct the assessee to file all the relevant documents as required to determine the allowability of deduction of ESOP discount if any reimbursed to the parent company under section 37(1) in the hands of the assessee for years under consideration.

**Accordingly, ground nos. 3 to 4 stands allowed partly for statistical purposes.**

**6. Ground no. 5** is raised by assessee against the disallowance of the claim of expenses made under the head miscellaneous expenses amounting to Rs.3,44,65,841/- and staff welfare expenses amounting to Rs.7,49,44,494/-.

**6.1** The Ld.AO had called for the details to verify the above expenses. On perusal of the assessment order, we note that assessee had not furnished the details called for. The Ld.AO therefore remitted the disallowance at 10% of the total expenses. Aggrieved by the order of the Ld.AO, assessee preferred appeal before the Ld.CIT(A).

**6.2** Before the Ld.CIT(A), assessee provided break-up of expenses but did not file supporting evidence like copy of ledger accounts of the expenses claimed. The Ld.CIT(A) thus upheld the disallowance made by the Ld.AO on an estimate basis. We note that assessee had filed additional evidences regarding ledger account of the expenses claimed before the Ld.CIT(A) which has not been admitted and therefore remained unverified. In the interest of justice, we remit this issue back to the Ld.AO to verify the same and to consider the claim in accordance with law.

**Accordingly, this ground raised by assessee stands partly allowed for statistical purposes.**

**7. Ground no. 6** raised by assessee is premature at this stage and does not require adjudication.

**In the result, the appeal filed by the assessee stands partly allowed for statistical purposes.**

**Order pronounced in the open court on 16<sup>th</sup> May, 2024.**

Sd/-  
(CHANDRA POOJARI)  
Accountant Member

Sd/-  
(BEENA PILLAI)  
Judicial Member

Bangalore,  
Dated, the 16<sup>th</sup> May, 2024.  
/MS /

Copy to:

- |               |                        |
|---------------|------------------------|
| 1. Appellant  | 2. Respondent          |
| 3. CIT        | 4. DR, ITAT, Bangalore |
| 5. Guard file | 6. CIT(A)              |

By order

Assistant Registrar,  
ITAT, Bangalore