

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH, C: NEW DELHI**

**BEFORE SHRI VIKAS AWASTHY, JUDICIAL MEMBER
AND
SHRI BRAJESH KUMAR SINGH, ACCOUNTANT MEMBER**

**ITA Nos.5624/Del/2010 & 5465/Del/2011
[Assessment Years: 2006-07 and 2007-08]**

HCL Technologies Limited, 806, Siddhartha 96, Nehru Place, New Delhi.	Vs	Asst. Commissioner of Income Tax, Central Circle-2, New Delhi.
PAN- AAACH1645P		
Assessee		Revenue

Assessee by	Shri Ajay Vohra, Sr. Adv., Shri Neeraj Jain, Adv., Shri Aditya Vohra, Adv., Shri Arpit Goyal, CA & Shri Shashvat Dhamija, Adv.
Revenue by	Shri G.C. Srivastava, Special Counsel (VC), Shri Kalrav Malhotra, Adv.

Date of Hearing	16.01.2026
Date of Pronouncement	15.04.2026

ORDER

PER BRAJESH KUMAR SINGH, AM,

These two appeals have been preferred by the assessee against the Final Assessment Order dated 28.10.2010 and 30.10.2011 passed by the ACIT, Central Circle-2, New Delhi, and ACIT, Central Circle-18, New Delhi(hereinafter referred

to as the 'ld. AO') under Section 143 read with Section 144C(13), of the Income-tax Act, 1961 ("the Act"), pursuant to the directions of the Hon'ble Dispute Resolution Panel-2, New Delhi (DRP) order dated 30.09.2010 and 20.09.2011 for the Assessment Year 2006-07 and 2007-08 respectively.

2. There are multiple common grounds in both the appeals. During the course of the hearing, the assessee filed a tabular chart for both the appeals and paper books and a compilation of case laws, which will be referred as per the requirement in this order.

2.1 During the pendency of the appeal, the assessee also filed additional grounds. These additional grounds along with the grounds of appeal will be dealt later in this order.

2.2. Further, the assessee also filed additional evidences in support of its claim of credit of Foreign Tax Credit of Rs. 15,20,58,506/-.

2.3 Further, the Spl. Counsel of the Department filed a written submission dated 07.07.2025 and the assessee filed a rejoinder dated 04.08.2025.

2.4 Necessary references will made to all the said documents evidences at the appropriate place as per its relevance and its requirements.

2.5 Since in both the apples issues are largely common issues are involved and therefore the same are disposed by this common order for the sake of convenience and brevity.

ITA No.- 5624/Del/2010 for A.Y. 2006-07

First, we take up the appeal for A.Y. 2006-07 in ITA no.- 5024/Del/2010.

3. The assessee had filed its return of income on 27.11.2006 declaring total income of Rs.4,08,00,448/-. Later on, the assessee filed a revised return on 28.3.2008 declaring total income of Rs. Nil.

3.1 During the year, the assessee was engaged in the business of development and export of computer software and rendering technical services. In the original return filed the assessee had shown gross income from business at Rs.650,42,87,652/- and deduction u/s 10A of the Act of Rs 644,73,03,493/- was claimed and business income was shown at Rs. 5,69,84,159/-. In the revised return gross income from business and profession was shown at Rs. 626,69,24,986/- and deduction a/s 10A was claimed at Rs. 629,41,97,556/- and loss from business and profession has been shown at Rs. 2,72,72,570/-. The assessee filed certificates in Form 56F in support of its claim of deduction u/s 10A of the Act, claimed in original as well as in the revised return. The reasons for filing the revised return filed by the assessee was explained by the assessee that ESOP expenses amounting to Rs. 23,76,60,350/- were claimed as deductible expenses in the revised return of income.

4. Now, the issues are taken up ground wise and additional ground of appeal wise.

4.1 Ground no. 1 of the appeal is general in nature and needs no separate adjudication.

5. Ground nos. 2 to 2.16 of the appeal are against the rejection by the AO in respect of the claim of the assessee that each of the Software Technology Park (STPI) unit be treated as separate undertaking instead, computing and restricting the deduction under section 10A of the Act by linking it with the licenses obtained by the assessee. The facts as noted relating to this issue by the Ld. DRP are narrated in its order under section 144 C (5) of the Act dated 30.09.2010, while affirming the findings of the AO in the draft assessment order dated 18.12.2019. The relevant extract of the same are reproduced as under:

“ The assessee's objections are discussed as follows:

A. Corporate Issues.

1. Objections regarding deduction u/s 10A of the Act.

(a) The assessee has claimed that it had 31 separate software development centers and each software development center represents a separate undertaking for the purpose of deduction u/s 10A of the Income Tax Act. This claim of the assessee was based on the submission that though the assessee was running all these 31 software development centres under 13 licenses issued by the STPI authorities, but there were 31 undertakings registered with the STPI and custom authorities and that each of the 31 undertakings was set up as an independent stand alone undertaking for production of computer software. It was the contention of the assessee that although, the 31 undertakings were operating only under 13 licenses granted by the STPI authorities but these were operating in separate premises with separate addresses also in most of the cases.

The AO however, did not accept this contention of the assessee. The AO tread the group of all the development centres operating under one license granted by the STI authorities as one undertaking for the purpose of granting deduction u/s 10A of the I. T. Act.

The ultimate effect of assessee's claim and the AO's decision is that by treating all the software development centres under one license as one undertaking for the purpose of deduction u/s 10A, the losses in some of the development centers get set off against the profit of the other development centres resulting in the lower cumulative profits and as such lower deduction u/s 10A of the I. T. Act. If the position of the assessee was accepted by the AO, the losses of the development centres, will not be set off against the profits of the remaining development centres and as such, there will be a higher amount of deduction u/s 10(A) of the I. T. Act.

We have given a careful consideration to the claim of the assessee and various arguments advance by the Ld. ARs in support of the claim. We, however find that the claim of the assessee cannot be accepted. The registration granted to the separate software development centres by the STPIs and by the Custom Authorities in no way satisfies the condition that each software development centre is a separate undertaking. These registrations are granted for different purposes. The registration granted by the STPI, is only a certificate that the entire production of that software development centre will be exported. Similarly, the registration granted by the custom authority is also for this purpose and for the additional purpose that the said software development centre will be held as bonded premises for removal of the software manufactured in the premises. That is the only reason for getting these registrations whenever a new development centre is added to the existing development centre running under a license already granted. The software development center added under each license is only an extension of the original undertaking set off under the license granted by the STPI authorities. Therefore the development centers, added subsequent to opening of the centres under the original license is only an expansion of the original undertaking and in no way can be treated as a separate undertaking for the purpose of deduction u/s 10A of the I. T. Act. The AO's observations in this regard in the assessment order for A.Y 2005-06 are important.

The AO has mentioned that the examination of Form No. 56F filed by the assessee reveals that the majority of the cases of original centre have been split up into different centres and the separate form 56F has been filed for each and every split centre, thereby claiming deduction u/s 10A for each centre. The AO has given example of such splitting up of the units in the assessment order. It is also noteworthy that in the original return for A.Y 2005-06, the assessee itself has claimed deduction u/s 10A as if, it had only 13 undertakings. It is only by way of revised return that the deduction u/s 10A have been claimed showing that the assessee had separate 31 undertakings. Up to A.Y 2004-05 and till even filing of there original return for A.Y 2005-06, the assessee has been claiming deduction u/s 10A on the basis that all the development centres operating under one license is one undertaking for the purpose of deduction u/s 10A. In this regard, the reference to the principle of statusquo laid down by various judgment of out of

Hon'ble Supreme Court and various High Court that the position which is settle for-a long time will not be unsettled unless there is a material change in the facts and circumstance of the case.

In view of the above, we agree with the AO's findings that the assessee did not have 31 separate undertakings but it had only 13 separate undertakings as operating under 13 licenses issued by the STPI authorities. As such, the AO is justified in his approach in restricting the deduction u/s 10A of the I. T. Act on the basis that the assessee was having only 13 undertakings."

5.1 Upon receipt of the above directions of the Ld. DRP the AO passed the final assessment order restricting the claim of the assessee under section 10 A of the Act to Rs. 448,57,33,115/- instead of the claim of the assessee company amounting to Rs. 629,41,97,557/- in the return of income, thereby making an addition of Rs. 180,84,64,441/-. The relevant findings of the AO in para 12 is reproduced as under:

" 12.Accordingly, the conclusion as drawn in the draft assessment order on this issue. upheld by the DRP, is considered as final and conclusive and the taxable income of the assessee is computed here under by allowing deduction under Section 10A of the Income Tax Act, 1961, in the same manner as it was done so in the draft assessment order. Accordingly, deduction u/s 10A of the Income Tax Act, 1961, is reduced to Rs. 448,57,33,115 / instead of claim of the assessee company amounting Rs. 629,41,97,556 in the return of income, thereby making an addition of Rs. 180,84,64,441/- to the returned income of the assessee. As there has been furnishing of inaccurate particulars/concealment of income by the assessee company, penalty proceedings u/s 271 (1) (c) is initiated separately."

5.2 Aggrieved with the said order, the assessee is an appeal before us on the following grounds:

2. That the assessing officer erred on facts and in law in denying the deduction under Section 10A of the Income-tax Act, 1961 ("the Act") in respect of the profits derived from the various undertakings owned by the appellant in the complete disregard of actual facts and circumstances.

2.1 *That the assessing officer erred on facts and in law in drawing an adverse inference regarding the eligibility of some of the undertakings owned by the appellant for the purpose of claiming deduction under Section 10A of the Act even without considering all the documentary evidence filed and placed by the appellant on record in support of its claim.*

2.2 *That the assessing officer erred on facts and in law in denying deduction under Section 10A of the Act in respect of the profits derived from the various undertakings owned by the appellant alleging that (a) the original 27 undertakings (including the undertakings owned by the erstwhile entities which were amalgamated with the appellant during the year under consideration) were split into 53 undertakings by the appellant in the revised return of income (b) no separate license was obtained by the appellant from STPI Authorities in respect of these undertakings and (c) that deduction in respect of these undertakings was deliberately not claimed by the appellant in the initial years.*

2.3 *That the assessing officer erred on facts and in law in drawing an adverse inference regarding the independent and separate, nature of the undertakings owned by the appellant not appreciating that each of such undertaking of the appellant is an independent viable unit registered with STPI Authorities and were eligible for deduction under section 10A of the Act.*

2.4 *That the assessing officer erred on facts and in law in arbitrarily concluding that the ratio of the decision of the Hon'ble apex court in the case of Textile Machinery Corporation Ltd. vs. CIT: 107 ITR 1955 (SC) is not applicable in the case of the appellant without considering the actual facts and circumstances and also overlooking the necessary evidence filed by the appellant in the course of impugned assessment proceedings in support of new and independent nature of undertakings owned by the appellant.*

2.5 *That the assessing officer erred on facts and in law in not appreciating that Section 10A of the Act is a complete code in itself and only those conditions which are prescribed by Section 10A of the Act are liable to be fulfilled by an undertaking for being eligible for the purpose of deduction under Section 10A of the Act.*

2.6 *That the assessing officer erred on facts and in law in arbitrarily concluding that the different undertakings covered under a single STPI License represent a single undertaking with multiple locations in the complete disregard of the certificate issued by the Chennai STPI Authorities upon the request made by the appellant to the said authorities.*

2.7 *That the assessing officer erred on facts and in law in concluding that the undertakings owned by the appellant do not represent new undertakings despite the fact that these undertakings have separate identifiable work force and set up as independent viable units.*

2.8 *That the assessing officer erred on facts and in law in concluding that the undertakings owned by the appellant do not represent new undertakings despite the*

fact that these undertakings were clearly engaged in newer and different technology areas.

2.9 That the assessing officer erred on facts and in law in drawing an adverse inference regarding the fulfillment of condition of setting up of each undertaking with substantial new investment without considering the details of capital investment made by each undertaking and the necessary evidence in support thereof filed by the appellant in the course of impugned assessment proceedings.

2.10 That the assessing officer erred on facts and in law in concluding that in a number of cases, the ultimate customer of the assessee is a group company in the complete disregard of the contention of the appellant that the group company represents only the immediate customer of the appellant and the ultimate customer always is third party independent customer.

2.11 That the assessing officer erred on facts and in law in drawing an adverse inference regarding the eligibility of the undertakings owned by the appellant for the purpose of claiming deduction under Section 10A of the Act merely on the ground that all the undertakings do not have their separate bank account without appreciating the fact that no such condition has been prescribed under Section 10A of the Act.

2.12 That the assessing officer erred on facts and in law in concluding that it is not possible to verify whether the condition regarding the setting up of each undertaking with substantial fresh investment is satisfied in the first year or not despite the fact that all the necessary details and evidence in support of substantial new capital investment is very much available on record.

2.13 That the assessing officer erred on facts and in law in drawing an adverse inference regarding the eligibility of the different undertakings owned by the appellant without appreciating the fact that the basis of determining the profits derived by the appellant from each of the undertakings were duly explained by the appellant and the same were duly verified by the learned assessing officer in the course of impugned assessment

2.14 That the assessing officer erred on facts and in law in concluding that the condition regarding the filing of a separate Form 56F by each undertaking has not been fulfilled in the earlier years without appreciating that the said condition was not applicable in the earlier years

2.15 That the assessing officer erred on facts and in law in discharging his statutory obligation to rebut all the judicial pronouncements relied upon in support of claiming of deduction under Section 10A of the Act.

2.16 That the Hon'ble Dispute Resolution Panel ("DRP") erred on facts and also in law in arbitrarily upholding the proposed action of the assessing officer of drawing adverse inference regarding the eligibility of the some of the undertakings to separately claim deduction under Section 10A of the Act ever without considering all the facts and evidence on record."

5.3 This issue, first arose in A.Y. 2005-06, wherein similar claim for enhanced deduction u/s 10A of the Act was claimed for the first time, which was not accepted by AO while passing the Assessment order, wherein he restricted the claim on the ground that all the new undertakings claimed by the assessee was an extension of its existing business. The said view of the AO was confirmed by the Co-ordinate Bench of the Tribunal in ITA No. 5623/Del/2010 vide its order dated 30.05.2014. In this regard, the relevant finding of the Co-ordinate Bench of the Tribunal in para no. 7.6 of its order which is reproduced as under:

“ 7.6 Before parting we deem it appropriate to record that there is no document available on record on the basis of which an inference can be drawn that the assessee's application before the STPI Authorities was for setting up a new undertaking and not for expanding an existing undertaking. The reliance placed on the Certificate of STPI, Chennai is of no help as it is ambiguously worded. The record shows that assessee has never placed on record the document seeking STPI permission either before the AO nor before the DRP and as observed has also not even been placed before us. In fact the assessee has never even pleaded that any such document was available with it despite the pointed arguments of the Revenue. It is curious to note that no attempt in the course of the hearings has been made on behalf of the assessee to either seek permission to place any such evidence on record or seek permission to file the same before the AO. Considering the entirety of the facts, circumstances, decisions, findings and pleadings of the parties, we are inclined to agree with the departmental stand that had any such document been available with the assessee then attempt to bring the same on record would have been done.”

5.4 Against the said order of the Tribunal, the assessee filed an appeal before the Hon'ble Delhi High Court, which vide its order dated 15.04.2015 in the case of HCL Technologies vs ACIT (377 ITR, 483 Delhi) [2015] affirmed the above findings of the Co-ordinate Bench of the Tribunal, by answering the said question

in the favour of the Revenue and dismissed the appeal of the assessee. The said substantial question no. 2 of law before the Hon'ble Delhi High Court in this case, and the decision of the Hon'ble Court in respect of the said question, in para no. 23 to 26 of its order are reproduced as under:

Question no. 2- *Whether, on facts, the appellant's contention that the new units claimed by it to be separate undertakings for the purpose of Section 10A of the Act is correct?*

" 23. These observations of the AO were upheld by the ITAT and based on the material available on record, it did not find any infirmity in the AO's finding. The appellant had urged before the ITAT that each software development Centre owned by it is and always had been treated as a separate undertaking. For this, it relied upon the assessment order for 1999-2000, where reference to the 15 undertakings was been made by the AO. The ITAT rejected this contention after having examined the contents of the assessment order. Facially, the assessment order for the assessment year 1999-00, as extracted by the ITAT in the impugned judgment, indicates that contrary to the assessee's submission, unit-wise break-up of profits was not provided by it. The assessee contended that a complete copy of the assessment order was provided to the ITAT during the course of the hearing. However, this Court is inclined to reject this contention in light of the following pointed observations of the ITAT on this issue:

"7.6. Before parting we deem it appropriate to record that there is no document available on record on the basis of which an inference can be drawn that the assessee's application before the STPI Authorities was for setting up a new undertaking and not for expanding an existing undertaking. The reliance placed on the Certificate of STPI, Chennai is of no help as it is ambiguously worded. The record shows that assessee has never placed on record the document seeking STPI permission either before the AO nor before the DRP and as observed has also not even been placed before us. In fact the assessee has never even pleaded that any such document was available with it despite the pointed arguments of the Revenue. It is curious to note that no attempt in the course of the hearings has been made on behalf of the assessee to either seek permission to place any such evidence on record or seek permission to file the same before the AO. Considering the entirety of the facts, circumstances, decisions, findings and pleadings of the parties, we are inclined to agree with the departmental stand that had any such document been available with the assessee then attempt to bring the same on record would have been done." (Emphasis supplied)

24. The appellant places great reliance on the Supreme Court's decision in Textile Machinery Corpn. Ltd. (supra) to contend that the 31 units were separate undertakings for the purposes of Section 10A. While the said decision did deal with the issue of determining the existence of a new undertaking (albeit under Section 15C of the Income Tax Act, 1922), the Supreme Court itself held that the answer (as to whether a unit is a separate undertaking) depends upon the peculiar facts and circumstances of each case

and no hard and fast rule can be laid down to determine the issue. Indeed, the answer to such a query, ultimately ought to be fact specific, and the lower authorities have arrived at their conclusion based on an adequate facts.

25. The appellant had urged that only the basis of the claim of deduction under Section 10A of the Act was sought to be altered in the revised return by treating each of the 31 undertakings created under the umbrella of 13 licences as separate undertakings. However, since the deduction under Section 10A is available to each undertaking, and given the concurrent finding of fact of lower authorities wherein they have held the material on record to be insufficient to trat each of the 31 unit, as separate undertakings, this Court holds that no interference on this issue is warranted. Consequently, it is held that the 31, cannot be treated as separate undertakings for the purpose units of availing benefit under Section 10A of the Act.

26. Thus, the second question on the merits of the rejection of the claim for deduction under Section 10-A is answered in favour of the revenue and against the assessee. As a result, its appeal fails and is accordingly dismissed.”

(emphasis supplied by us)

5.5 Further, the Co-ordinate Bench of in para no. 7.7. of the Tribunal held against the claim of the assessee from resiling from its position in respect of the claim of the assessee that each of the Software Technology Park (STPI) unit be treated as separate undertaking instead, computing and restricting the deduction under section 10A of the Act by linking it with the licenses obtained by the assessee. The said findings of the Tribunal in para no. 7.7 are reproduced as under:

“ 7.7 On examining the claim of the assessee on facts we find that the authorities below have come to a correct conclusion as the claim now put forth by way of a revised return relying on judgements which have been rendered on facts peculiar to their own cannot be said to lay down a legally binding precedent that the same lay down a precedent based on which the assessee can resile from its stated position. The stated position being referred to herein does not refer to the filing of returns in one of two years but at times for 10 years, and 7 years and 5 years or so. Accordingly for the detailed reason given hereinabove the grounds raised by the assessee qua the issue is dismissed.”

5.6 Against the said findings of the Tribunal in the appeal filed by the assessee, the Hon'ble High Court in the aforesaid appeal framed substantial question of law no. 1, which was answered in favour of the assessee. The substantial question of law no. 1 in this appeal and para no. 20 of the order of the Hon'ble Court in favour of the assessee is reproduced as under:

“Question no. (1) Whether an assessee is estopped under law from availing the benefits under Section 10A of the Act in respect of units for which it had not availed the said benefits previously, by treating units as distinct undertakings as opposed to expanded units of a single undertaking (as was done earlier)?

20. The impugned judgment erred in holding that the assessment would be guided by the appellant's treatment of its 'internal affairs' and that the assessee's claim must fail because it has "consistently taken a decision as per facts exclusively available to it in its personal domain on the basis of which the assessee has chosen to treat the expanded units as part of the 13 units". The authorities quoted above unequivocally establish that an assessee's treatment of facts in any given manner is not relevant for the purposes of determining liability under the Act. If, on an application of the statutory provision, the party is entitled to the benefits under the Act, the mere circumstance that for the past 5 to 7 years, or even 10 years, it did not claim such benefit would not preclude it from availing it in the assessment year in question. What the appellant cannot resile from is the existence of a given set of facts which it has not challenged earlier. However, if, based on the same set of facts, it now seeks to claim deduction under Section 10A which it had foregone earlier, the appellant's claim must be allowed, provided, of course, the requirements of Section 10A are satisfied. Therefore, in the instant case, in the event that the appellant establishes that the 31 units constitute separate undertakings for the purposes of Section 10A, it would be entitled to the claims made in the revised return. Accordingly, the first question is answered in favour of the appellant and against the revenue.”

5.7 In this regard, it was submitted by the Id. Counsel vide its original submission dated 25.06.2025 (on page 28) that the Hon'ble High Court at page 27 of its order referred to para 7.6 of the order passed by the Tribunal, wherein it was erroneously observed that “there is no document available on record on the basis of which an

inference can be drawn that the assessee's application before the STPI Authorities was for setting up a new undertaking and not for expanding an existing undertaking.....”.

5.8 Further, in its rejoinder dated 04.08.2025 the assessee submitted that the Hon'ble Delhi High Court had decided the first question, i.e., issue of estoppel in favour of the assessee, as explained above but admitted that the Hon'ble High Court had grossly erred in framing and deciding the second substantial question of law against the assessee, viz., whether the assessee's contention that the new units were separate undertakings for purposes of section 10A of the Act was correct? The relevant submissions in rejoinder dated 04.08.2025 of the assessee are reproduced as under:

“ 40. It is submitted that in further appeal, the Delhi High Court in decided the first question, i.e., issue of estoppel in favour of the Appellant, as explained above. However, the High Court grossly erred in framing and deciding the second substantial question of law against the Appellant, viz., whether the Appellant's contention that the new units were separate undertakings for purposes of section 10A of the Act was correct?”

41. It is vehemently submitted that in the appeal filed before the High Court, the Appellant had raised specific grounds that the order of the Hon'ble Tribunal required reconsideration inasmuch as the claim of deduction had been rejected without going into the merits of the claim. The same, however, was erroneously ignored while deciding the appeal and recording that lower authorities had given concurrent findings of facts that material on record was insufficient to treat each of the 31 undertakings as separate undertakings. It is submitted that in SLP filed by the Appellant against the aforesaid findings of the High Court rejecting the claim of deduction under section 10A of the Act on merits, the Supreme Court has granted leave vide order dated 13.03.2018 passed in SLP(C) 18864-18865/2016. [Refer page 345 of Case Laws Paper Book]”

(emphasis supplied by us)

5.9 Against the above order of the Hon'ble Delhi High Court, in respect of Ground no. 2 of the appeal, the assessee filed an SLP before the Hon'ble Supreme Court, wherein the appeal was admitted by the Hon'ble Supreme Court and the Hon'ble Apex Court vide order its dated 13.03.2018 ordered, 'Leave granted'. Therefore, the point of consideration before us regarding the above claim of the assessee during this year is limited to the fact as to whether there was any document available on record on the basis of which inference could be drawn that assessee's application before the STPI Authority was for setting up a new undertaking and not for expanding its existing undertaking than what was available before the Tribunal and the Hon'ble Delhi High Court, when it decided the said appeal of the assessee for A.Y. 2005-06 against it. In this regard, the assessee vide letter dated 27.06.2025, during the course of hearing before us, placed certain documents to establish that the setting up for a new undertaking. The relevant document in this regard placed by the assessee are reproduced as under:

Ms R RAJALAKSHMI
Director - In-Charge
Software Technology Parks of India
No 480, II Floor, Khivaraaj Complex II
Anna Salai
Madras-600 035

Ref.No. HCL-GISTP/IMP/014
Date : 07-Jan-1997

Dear Madam,

Sub: Request for Approval for Additional Locations for Software Development -Reg.

- Ref : 1. HCL Consulting Ltd. STP Unit approval No. STPB/HCL-CONSULTING/94/2112 and STPB/94/2111 dt 26th Dec 94
2. Your letter Ref. No. STPM(B)/G111/95-96/523, dt 28.08.95
3. Your letter Ref. No. STPB/HCL-CONSULTING/96/1527 DT 26.02.96
4. Our letter Ref. No. HCL-C/STP/96/017 dt 12.08.96
5. Our Telephonic Discussion of date
6. Our letter Ref. No. HCL-C/STP/96/012 dt 27.12.96
7. Your Approval Ref. No. STPM(B)/G111/96-97/1163 dt 16.01.1997.

Thank you for your kind approval for Capital goods Enhancement from Rs.15.00 Crores to Rs.40.63Crores. We are glad to state that one of our customers, CISCO Systems, has expanded the scope of the project to be executed at our offshore Development Centre. We had submitted the application for Capital Goods Enhancement in anticipation of our expansion of our software development operations. Now your goodself have approved our request and issued your kind approval vide your Approval Ref. No. STPM(B)/G111/96-97/1163 dt 16.01.1997. We once again thank you for your kind help.

We wish to state that from our group companies operating overseas, we understand that there are immense opportunities for Software development and Export from India. Based on this, HCL Management has decided to give a major thrust to Software Export Activities and is in the process of developing the infrastructure. We have imported an IBM machine at Madras.

We wish to state that that to meet our business requirements we have executed the Lease Agreement for the premises at 4th Floor, 50-53, Greams Road, Murugesha Naicker Office Complex, CHENNAI-600 006 and No.49-50, Nelson Manickam Road, CHENNAI-600 029 for our Software Development operations.

We wish to state that with your kind approval, we would like to bond the following premises with the Customs Authorities to meet our immediate requirements for our software Development operations :-

1. 4th Floor, 50-53, Greams Road, Murugesha Naicker Office Complex, CHENNAI-600 006

- 2 -

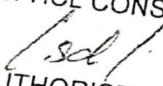
2. Basement, Ground Floor and Second Floor, No.49-50, Nelson Manickam Road, CHENNAI-600 029

We expect that our request will be favourably considered so that we can meet the deadlines of our customers and will help us in getting more projects.

We request your goodself to kindly arrange issue your kind approval at your earliest convenience.

Thanking you,

Yours faithfully,
for HCL CONSULTING LIMITED


AUTHORISED SIGNATORY

5.10 On the other hand, the Ld. Spl. Counsel for the Department relied upon the order of the Tribunal and the Hon'ble Delhi High Court and the findings of the

lower authorities. The relevant extracts of his submissions dated 07.07.2025 are reproduced as under:

“xxi. The issue of treating the 31 units as separate undertakings for Section 10A purposes for A.Y. 2005-06 has been definitively settled by the Hon'ble Delhi High Court in the Assessee's own case, HCL Technologies Ltd. vs. Assistant Commissioner of Income Tax (ITA 46/2015), vide judgment dated 15.04.2015. That, while the Hon'ble High Court held that an assessee is not estopped from revising a claim based on a correct legal position (answering the first substantial question of law in favour of the Assessee), it unequivocally decided the second substantial question of law against the Assessee. The second question was:

"Whether, on facts, the appellant's contention that the new units claimed by it to be separate undertakings for the purposes for Section 10A of the Act is correct?". The Hon'ble Delhi High Court's binding pronouncement on this factual aspect is clear:

"The appellant had urged that only the basis of the claim of deduction under Section 10A of the Act was sought to be altered in the revised return by treating each of the 31 undertakings created under the umbrella of 13 licences as separate undertakings. However, since the deduction under Section 10A is available to each undertaking, and given the concurrent finding of fact of lower authorities wherein they have held the material on record to be insufficient to treat each of the 31 units as separate undertakings, this Court holds that no interference on this issue is warranted. Consequently, it is held that the 31 units cannot be treated as separate undertakings for the purposes of availing benefit under Section 10A of the Act.

xxiii. This decision of the jurisdictional High Court is binding on this Hon'ble Tribunal for the present assessment year, as the underlying facts and circumstances regarding the nature of these units (whether expansions or separate undertakings) remain identical to those in A.Y. 2005-06. No new material facts have been brought on record for A.Y. 2006-07 that would warrant a deviation from this binding precedent. To re-examine or overrule this settled factual position would constitute a serious breach of judicial discipline.

xxiv. In fact, even before the Hon'ble Delhi High Court's binding judgment, the ITAT's order for AY 2005-06 thoroughly analysed and rejected the Assessee's arguments on the "separate undertaking" issue. This detailed order of the Co-ordinate Bench of the Hon'ble ITAT in the Assessee's own case for the immediately preceding year ie, A.Y. 2005-06, serves as a strong precedent. especially since the factual premise for both years is identical.”

(emphasis supplied by us)

5.11 However, the Ld. Counsel in its rejoinder reiterated its submissions that the Tribunal in its order dated 30.05.2014 for AY 2005-06 did not go into the merits of the claim of the assessee and its findings were restricted itself to the question whether the Appellant was estopped in law in revising its claim under section 10A of the Act, in year(s) subsequent to setting up of the undertaking. The relevant submissions of the Ld. Counsel is reproduced as under :

39. It is respectfully submitted that the Hon'ble Tribunal vide order dated 30.05.2014 passed in the Appellant's case for assessment year 2005-06 restricted itself to the question whether the Appellant was estopped in law in revising its claim under section 10A of the Act, in year(s) subsequent to setting up of the undertaking, more so considering that the Appellant had itself treated such (new) undertakings as expansion of the existing original undertakings. The relevant findings of the Hon'ble Tribunal are contained in paras 3.11, 7, 7.3 & 7.3.1 of the decision, which are not reproduced here for sake of brevity. Having held so, the Tribunal did not go into the merits of the claim.

(emphasis supplied by us)

5.12 During the course of hearing, a specific query was made to the Senior Counsel of the assessee as to whether any new documents other than what was submitted by the assessee during the appellate proceedings before the Tribunal in the case of the assessee for A.Y. 2005-06 as well as before the Hon'ble Delhi High Court for the said was filed before us in the present appeal. The Ld. Counsel

submitted that no new document other than what was submitted for A.Y. 2005-06 in the above appellate proceedings was submitted before us for the present appeal.

5.13 We have heard the rival submissions and perused the material available on record. Thus, it is seen that both the Co-ordinate Bench of the Tribunal as well the Hon'ble Delhi High Court on this issue after considering the said documents which are also before us held that 31 units cannot be treated as separate undertaking for the purposes of availing benefit u/s 10A of the Act. This fact has also been admitted by the assessee in its submission, which has been reproduced earlier in this year's order and are being reproduced once again.

“ 40. It is submitted that in further appeal, the Delhi High Court in decided the first question, i.e., issue of estoppel in favour of the Appellant, as explained above. However, the High Court grossly erred in framing and deciding the second substantial question of law against the Appellant, viz., whether the Appellant's contention that the new units were separate undertakings for purposes of section 10A of the Act was correct?

41. It is vehemently submitted that in the appeal filed before the High Court, the Appellant had raised specific grounds that the order of the Hon'ble Tribunal required reconsideration inasmuch as the claim of deduction had been rejected without going into the merits of the claim. The same, however, was erroneously ignored while deciding the appeal and recording that lower authorities had given concurrent findings of facts that material on record was insufficient to treat each of the 31 undertakings as separate undertakings. It is submitted that in SLP filed by the Appellant against the aforesaid findings of the High Court rejecting the claim of deduction under section 10A of the Act on merits, the Supreme Court has granted leave vide order dated 13.03.2018 passed in SLP(C) 18864-18865/2016. [Refer page 345 of Case Laws Paper Book]”

(emphasis supplied by us)

5.14 Against the above findings of the Hon'ble Delhi High Court, the assessee has filed an appeal before the Hon'ble Apex Court, wherein leave has been granted.

Thus, as on date, order dated 30.05.2014 of the Co-ordinate Bench and affirmed by the Hon'ble Delhi High Court vide its order dated 15.04.2015 in assessee's own case for A.Y. 2005-06 as referred above (on the same material facts as available for AY 2006-07 before us), which held that 31 units cannot be treated as separate undertaking for the purposes of availing benefit u/s 10A of the Act has not been overruled. Respectfully following the same we hold that the claim of the assessee for treating the 31 units as separate undertaking for the purposes of availing benefit u/s 10A of the Act is not acceptable and the same is rejected. Accordingly, we uphold the order of the AO in restricting the allowance claimed by the assessee at Rs. 448,57,33,115/- as against Rs. 629,41,97,557/- claimed by the assessee. Consequently, the addition of Rs. 180,84,64,441/- is confirmed and accordingly we dismiss ground nos. 2 to 2.16 of the appeal.

6. Ground nos. 3 to 3.3 and 4 to 4.2 of the appeal relate to the dispute with respect to computation of deduction allowed under section 10A of the Act by reducing 60% of expenses incurred in foreign currency from the 'Export Turnover' on the alleged ground that the same were incurred for rendering technical services outside India and Computation of deduction allowed under section 10A of the Act by reducing link charges attributable to delivery of computer software outside India from 'Export Turnover', without making similar adjustment from 'Total Turnover'

6.1 The relevant findings of the AO in the draft assessment order are reproduced as under:

“16. The assessee company has claimed deduction u/s 10A in respect of various units. It is seen that while computing the deduction. The assessee has not made any adjustment from the export turnover as is required to be made as per clause (iii) of Explanation 2 under section 10A of the Act.

In this case two important issues are to be brought on record in respect of assessee's claim for deduction u/s 10A.

The first issue is regarding the definition of export turnover and total turnover and the 2nd issue is concerned with rendering technical services outside India.

In section 10A the definition of export turnover has been provided as under:

"Export turnover" means the consideration in respect of export (by the undertaking) of articles or things or computer software received in, or brought into India by the assessee in convertible foreign exchange in accordance with sub section (3), but does not include freight telecommunication charges or insurance attributable to the delivery of the articles or things or computer software outside India or expenses, if any, incurred in foreign exchange in providing the technical services outside India:

Thus it is clear from the definition that the following expenses have to be deducted to arrive at the quantum of export turnover:

- a) Freight.*
- b) Telecommunication.*
- c) Insurance.*

As per the definition these expenses have to be deducted from the export turnover to the extent they are attributable to the delivery of goods/article/software outside India These expenses have to be deducted whether they are incurred in India currency or in foreign exchange

Now coming to the definition of total turnover, it is seen that, there is no such definition in Explanation 2 to Section 10 or any other explanation in Section 10. Since there is no definition of total turnover in the section, therefore, the usual definition of total turnover has to be taken which in other words implies that from the total turnover, no such expenses or any other expenses here to be deducted.

Thus as per definition of export turnover communication expenses incurred towards actual delivery of software outside India and expenses incurred in foreign exchange in rendering services outside India are to be reduced from the export turnover only.

As in the earlier previous years i.e. assessment year 2004-05 and 2005-06, the assessee was asked to explain why the expenses on account of telecommunication/link charges

etc. for delivery of goods and expenses incurred in foreign exchange for providing technical services outside India be not excluded from export turnover while computing deduction u/s 10A

The assessee has furnished written submissions vide his letter dated December 2, 2009. It is argued that the assessee company being engaged in the business of development and export of computer software only, no adjustment is warranted either from export turnover or from total turnover except on account of telecommunication expenses incurred by the assessee company for delivery of computer software outside India and that too is liable to be reduced from export turnover as well as total turnover. The reply filed by the assessee on this ground is similar to the reply filed during the course of assessment proceedings for the A.Y. 2004-05 and for AY: 2005-06.

Apart from the submissions furnished, the assessee has also contended that the similar issue in the case of the assessee for the earlier AV 2004-05 has already been decided upon by the ITAT in favour of the assessee

I have considered the submissions of the assessee and found no additional submission have been made by the assessee from the reply filed to the assessee two main arguments have emerged a) The assessee is not providing technical services therefore expenditure incurred in foreign exchange need not to be reduced either from the export turnover or from the total turnover.

b) If expenses incurred in foreign currency at all need to be reduced from the export turnover than simultaneously these expenses have to be reduced from total turnover as well in view of the definition of total turnover in Section 80HHC and 80HHE.

I have dealt both the issues in my order in detail separately in the order for A.Y. 2004-05 and For AY: 2005-06.

The assessee company has claimed deduction u/s 10A as per certificates filed in form no.56F. The assessee while computing the deduction has taken the same figure of export turnover as of total turnover. The assessee cited various judicial cases but the matter is still subjudice before the High Court

18. For the reasons discussed below, the definition of total turnover given in section 80HHC and 80HHE cannot be adopted for the purpose of section 10A.

a) When total turnover is not defined in section 10A, the ordinary meaning of the word is to be adopted. As it is a technical term, the technical meaning of total turnover, which does not envisage the reduction of any expenses from the total amount, is to be taken into consideration for computing the deduction u/s 10A

b) When the meaning is clear, there is no necessity of importing the meaning of total turnover from other provisions

c) *If a term is defined in section 2 of the Act. then definition would be applicable to all the provisions of the Act where the same term appears As the term 'total turnover has been defined in the Explanation to section 80HHC and 80HHE, wherein it has been clearly stated that For the purposes of this section only it is applicable only for the purposes of these sections and not for the purpose of section 10A.*

The following points are also to be considered to arrive at the conclusion whether these expenses have to be reduced from export turnover only or from both:

a) *Considering the fact that the deduction u/s 80HHC and 80HHE were being phased out, the provisions of section 10A and 10A were amended to provide for pro rata deduction from total income. The intent of legislation was such that freight, insurance and telecommunication charges incurred to the extent, attributable to the delivery of software outside India in the turnover should be excluded from the export turnover. Thus, it provide for the assessee who exports even 100% of its turnover to pay tax on a proportion of income.*

b) *As discussed in length in my order for the Asstt. Year 2004-05 and AY 2005-06, the definition of total turnover given in section 80HHE cannot be adopted for the purpose of section 10A. Accordingly, the specified deductions made from the export turnover cannot be reduced from the total turnover. Hence the total turnover is to be adopted without reducing the expenditure i.e. telecommunication/Link charges incurred for the actual delivery of software outside India*

c) *As per the definition of export turnover in Section 10A, it is seen that in the case of an assessee rendering technical services outside India, expenses incurred in foreign currency to that extent, have to be deducted from the export turnover. The difference between the first three expenses and expenses on technical services is that the first three expenses have to be deducted irrespective of the currency in which they have been incurred However for technical services only foreign currency expenses have to be deducted.*

19. *Now the important issue is to see whether the assessee is rendering technical services or not. The fact that the assessee is developing and supplying software is not disputed, what is disputed is that there is an important and crucial element of "Technical Services" involved in this exercise. The closest that the I.T.Act comes to defining technical services is in Section 9(1)(vii), which says that "fee for technical services means, any consideration for rendering of any managerial, technical or consulting services".*

20. *The issue has been discussed in length in my order for A Y. 2004-05 and after examining the profile of the company, the contention of the assessee that company is only engaged in the business of development and export of computer software was not found correct. The contention off the assessee that they have not rendered any technical, managerial or consultancy services to its customers for providing similar services is not acceptable. Assessee is taking services of engineers and other employees on account of salary, travelling and various other expenses outside India and incurred*

expenses thereon. These expenses are not for development of software in foreign countries but evidently these are for providing technical services to the offshore customers

21. In view of the facts discussed in proceeding assessment year and keeping in view business activities of the assessee company and that there may be some expenditure which might not relate to technical services but for traveling and other expenses of directors and other employees, I estimate such expenses @ 40% and remaining 60% for providing technical services by the assessee company in foreign exchange to its offshore clients as in the last A.Y.

22. The contention of the assessee that the ITAT while disposing the appeal for the A.Y. 2004-05 has upheld the impugned principal of making the similar adjustment from the "total turnover" in case some adjustment is made from the export turnover has been considered and not accepted. The department has not accepted the order of the ITAT and the said order is being challenged by the department before higher appellate authorities.

23 On the basis of above discussion, details filed on record on the issues, the deductions was 10A in respect of different units is to be re-computed."

(emphasis supplied by us)

6.2 The assessee filed objections before the ld. DRP against the above findings in the draft assessment order. The Ld. DRP rejected the objections filed by the assessee. The relevant extracts of the said directions are reproduced as under:

"(b) The next objection of the assessee is that the AO was not justified in calculating the amount of deduction allowable u/s 10A of the Act by reducing the expenses incurred in foreign currency for providing technical services. It is however seen that this issue is under litigation. The High Court has not admitted department's appeal against the order of the Tribunal which was in favour of the assessee. The matter for filing of SLP in this regard is under consideration by the department. Therefore, in order to maintain consistency and to protect the interest of the revenue, the AO's action in this regard is approved.

(c) The next objection of the assessee is against the AO's action in calculating the amount of deduction allowable w/s 10A of the Act by reducing the "data link charges" incurred for delivery of computer software outside India from export turnover only without any corresponding adjustment from the total turnover. This issue is also under litigation before the High Court. Therefore, for the sake of consistency and to protect the interest of the revenue this action of the AO is also approved."

(emphasis supplied by us)

6.3 Accordingly, deduction claimed by the assessee company was recomputed as proposed in the draft assessment order in the final assessment order which resulted into reducing the amount of deduction under Section 10A of the Income Tax Act. However, the AO observed that the assessee's claim for deduction under section has already been disallowed in para no 12 of the final assessment order and therefore no separate addition was being made on this ground as its impact was already included in the addition of Rs. 180,84,64,441/- made in Para 12 of the draft assessment order.

6.4 Aggrieved with the said order the assessee is in appeal before us on the following grounds of appeal:

"3. That the assessing officer erred on facts and in law in arbitrarily concluding that 60% of the aggregate amount of expenses incurred by the appellant in the convertible foreign exchange during the year under consideration was incurred in connection with technical services rendered by the appellant and was required to be reduced from "export turnover", in terms of clause (iv) of Explanation 2 of Section 10A of the Act

3.1 That the assessing officer erred on facts and in law in making the reduction of expenses incurred by the appellant in the convertible foreign exchange from " export turnover" following the assessment order for assessment year 2004-05, without appreciating that the the said issue has already been decided by the Hon'ble ITAT in favor of the appellant for the Assessment Year 2004-05 and even the departmental appeal against the said order of the ITAT has been rejected by the Hon'ble Delhi High Court.

3.2 Without prejudice and in the alternative, the assessing officer erred in not excluding the expenses incurred by the appellant in the convertible foreign exchange from 'total turnover' while reducing these from 'export turnover for calculation of deduction u/s 10A leading to absurd results.

3.3 That the Hon'ble DRP erred on facts and in law in upholding the proposed action of the learned AO of reduction of expenses incurred by the appellant from" export turnover" and, without prejudice, in not excluding the same from 'total turnover' as

well for computing deduction under section 10A of the Act by merely observing that the said issue is under litigation.

4. That the assessing officer erred on facts and in law in reducing link charges attributable to delivery of computer software outside India from "the export turnover" in terms of clause (iv) of Explanation 2 of Section 10A of the Act. without making the similar adjustment from the total turnover" resulting into absurd and unintended results.

4.1 That the assessing officer erred on facts and in law in making the reduction of link charges incurred by the appellant from "export turnover" without making the corresponding adjustment from "total turnover" following the assessment order for assessment year 2004-05, without appreciating that the said issue has already been decided by the Hon'ble ITAT in favor of the appellant for the Assessment Year 2004-05 and even the departmental appeal against the said order of the ITAT has been rejected by the Hon'ble Delhi High Court.

4.2. That the Hon'ble DRP erred on facts and in law in upholding the proposed action of the learned AO of reduction of expenses incurred by the appellant from "export turnover" for computing deduction under section 10A of the Act without making the corresponding adjustment from the "total turnover" by merely observing that the said issue is under litigation."

6.5 In this regard, the Sr. Counsel for the assessee submitted as under:

“AO order

The AO, relying on assessment order for AY 2004-05 held that 60% of the expenses incurred by the Appellant in foreign currency was towards rendering technical services outside India and are required to be reduced from 'Export Turnover' while computing deduction under section 10A of the Act. AO further reduced link charges attributable to delivery of computer software outside India from 'Export Turnover', without making similar adjustment from 'Total Turnover'.

DRP Order

DRP upheld the addition made by the AO on the ground that although the High Court had decided the issue in favour of the Appellant in respect of earlier AY, the Department was considering filing of SLP against the same.

Our submissions

For making the disputed adjustment in the computation of profits eligible for deduction under section 10A of the Act, the AO has relied on findings contained in assessment order passed in the case of the Appellant for AY 2004-05.

It is submitted that in appeal against the aforesaid AO order for AY 2004-05, this Hon'ble Tribunal vide order dated 23.01.2009 in ITA No.3344/Del/07, deleted the adjustment in deduction claimed under section 10A of the Act by holding that the Appellant was engaged in export of software and not in rendering technical services and therefore, the exclusion of expenses incurred in foreign currency from Export Turnover was not justified.

It is pertinent to note that the Hon'ble Delhi High Court vide order dated 15.12.2009 in ITA No.1250 of 2009 did not admit appeal of the Revenue against the aforesaid order passed by the Tribunal.

Further appeal by the Revenue before the Hon'ble Supreme Court stands dismissed vide order dated 24.04.2018 in CA Nos.8489-8490 of 2013 & others, reported as 404 ITR 719 (SC).

Further, the **CBDT vide Circular No. 4 of 2018, dated 14.08.2018**, has clarified that all charges/ expenses specified in Explanation 2(iv) to section 10A of the Act are liable to be excluded from total turnover also for the purpose of computation of deduction under section 10A of the Act and that the Revenue is not to press the said issue henceforth.

This Hon'ble Tribunal in assessee's own case for AY 2005-06 (ITA No.5623/Del/2010) also, following the aforesaid decision of the Tribunal for AY 2004-05, deleted similar disallowance of deduction under section 10A of the Act.

Similarly, in the case of DSL Software Ltd, i.e., one of the group companies which subsequently merged into the Appellant, **the Delhi Bench of the Tribunal in appeals for AY 2004-05 (in ITA Nos.3203 & 3204/Del/07), relied upon its earlier decision for AY 2003-04 (in ITA Nos. 1320 & 1448/D/08), and decided the impugned issue in favour of the Appellant.**

In view of the aforesaid, it is respectfully submitted that the AO has clearly erred in holding that 60% of the expenses incurred by the Appellant in foreign currency was towards rendering of technical services required to be reduced from 'Export Turnover' while computing deduction under section 10AA of the Act and the said adjustment deserves to be deleted."

(emphasis supplied by us)

6.6 The Ld. Spl. Counsel relied upon the order of the authorities below.

6.7 We have heard the rival contentions, and perused the material available on record. This issue had come up in the case of the assessee for A.Y. 2004-05, as noted by the AO in the assessment order and also in A.Y. 2003-04 and on similar facts, the coordinate bench of the Tribunal, in assessee's own case in ITA No. 5023/Del/2010 for A.Y. 2005-06 vide order dated 30.05.2014 in para no. 8 and 9 allowed similar grounds raised by the assessee and directed the AO to grant necessary relief. The above findings of the Tribunal, are reproduced as under:

“8. On a perusal of Ground No-4 to 4.4 agitated by the assessee it is seen that the assessee has assailed the action of the AO in calculating the amount of deduction allowable u/s 10A of the activity by reducing the expenses incurred in foreign currency for providing technical services. The draft order on this point was confirmed by the DRP leading to the passing of the order under challenge. It is seen that the issue had been decided in assessee's favour by the Tribunal in the immediately preceding assessment year which was not unsettled by the Hon'ble High Court. Only because SLP filing was under consideration the issue was kept alive by the AO. In the afore-mentioned peculiar facts and circumstances the reliance by the assessee on the order dated 23.01.2009 in ITA Nos.-3199 & 3144/Del/07) which view was also taken in 2003-04 assessment year and considering the departmental stand wherein reliance is placed on the orders of the authorities below and no contrary decision or judgement is cited disputing the view taken in the order to deviate from the stand taken by the ITAT we deem it appropriate since facts, circumstances and reasoning is identical to restore the issue back to the AO by allowing the ground raised and directing the AO to grant necessary relief following the orders of the ITAT wherein we note that the view take in 2003-04 A. Year has been considered by the Hon'ble High Court.

9. The next issue addressed by the assessee is set out in Ground No-5 to 5.2 wherein the action of the Assessing Officer has been assailed on the ground that the AO has from the calculation of deduction allowable u/s 10A of the Act reduced the “data link charges” incurred for delivery of computer software outside India from “Export Turnover” without making corresponding adjustment from the “Total Turnover”. The said issue was also decided by the AO against the assessee in order to keep the issue alive despite the fact that it was brought to the notice of the AO that it had been decided in assessee's favour by the Tribunal in the assessee's own case for 2004-05 assessment year. The Ld. Special Counsel herein also placed reliance upon the assessment order and the factual issue having been considered by the Tribunal was not disputed. In the circumstances

respectfully following the order of the Tribunal in 2004-05 assessment year, the ground raised is allowed and the AO is directed to grant necessary relief.”

(emphasis supplied by us)

6.8 Respectfully following the decision, the AO is directed to allow the claim of the assessee after due verification in the event of assessee succeeding in appeal in ground no. 2 to 2.16 of this appeal on further appeal if any filed by the assessee. Ground nos. 3 to 3.3 and 4 to 4.2 of the appeal are allowed as above.

7. In ground no. 5 to 5.5 of the appeal, the assessee is aggrieved by the action of the AO in not allowing the losses amounting to Rs. 22,22,88,862/- incurred by the STPI units to be set off against other taxable income of the Assessee. The details of the unit-wise losses are reproduced by the AO on page no. 39 the draft assessment order dated 18.12.2019.

7.1 The AO disallowed the above claim by taking a view that the profits and gains derived from the business eligible under section 10A do not form part of total income and since profits and gains include losses also, neither profit nor the loss from such business can be considered for the purpose of computing total income.

The relevant extract of the order of the AO is reproduced as under:

“24. In the return of income, the assessee has claimed the benefit of the losses of the undertakings represented by the following STPI Licenses, being covered under Section 10A of the Act, by setting off the below mentioned losses against the taxable incomes for the year under consideration:-

S.No.	Name of the Unit (as per the STP License)	Amount of Losses (Rs.)
1	STPI Noida -2 (445, dhyog Vihar, Phase II)	(128,898)
2	STPI Kolkatta (14th Fl,Infinity Tower-II,Plot A3,Block GP,Sec-V,Saltlake City,Kol-700091)	(23,363,093)
3	PSO Chennai -2 (III Floor,43,44,Montieth Road,Egmore, Chennai - 600 008)	(271,097)
4	PSO Kolkatta (SDF Building (1st Fl),Module No.228-230,Block GP,SaltLake, Sec V, Kolkata)	(28,565,805)
5	STPI Mumbai (B/304,C/301, Delphi, Hiranand, Mumbai – 400076)	(8,673,391)
6	STPI Noida -5 (C-22A, Sector-57, Noida)	(19,099,174)
7	HCL Technologies Ltd BPO-II (Block 2,84, Greams Road, Thousand Lights, Chennai,600006)	(15,841,286)
8	Noida BPO – 2 (B-34/3, SECTOR-59, NOIDA,201301)	(34,986.124)
9	Noida BPO – 3 (A-22, SECTOR-60, NOIDA 201307)	(91,359.993)
	Total	(222,288.862)

“ The assessee vide order sheet entry dated 2-11-2009 was asked to justify the setting off the losses of above referred undertakings against the taxable income rather than carrying forward these losses to be set off against the profits of these undertakings in subsequent assessment years.

The assessee vide its letter dated 4-11-2009 has submitted that the provisions of Section 10A of the Act (after its substitution by the Finance Act. 2001 w.e.f 01/04/2001) are deduction provisions in nature unlike exemption provisions earlier. The assessee has further explained the manner of computation of deduction allowable u/s 10A of the Act in respect of profits of an undertaking eligible for deduction u/s 10A of the Act. The assessee has also made reference of the Form-1 (the form prescribed for filing the return of income by a corporate assessee) prescribing the stage at which deduction allowable u/s 10A of the Act has to be deducted from the P/G/B/P for the purpose of calculating Gross Total Income. Apart from this, the assessee has also cited the CBDT Circular explaining the changes introduced by the Finance Act, 2001, and also the decision of Delhi ITAT in the case of Honeywell International Pvt. Ltd. in support of its contention.

24.1 After going through the submission made by the assessee in this regard, I am of the view that there is no merit in the contentions of the assessee. Section 10A within the Chapter III, which gives the title ‘Income which do not form part of total income. The profits and gains derived from the business eligible under section 10A do not form part of total income and since profits and gains include losses also, neither profits nor the loss from such business can be considered for the purpose of computing total income. Consequently, the losses arising from each unit cannot be set off under the provisions of Section 70 and 71 of the Act.

The assessee has not exercised option to non-applicability of the provisions of section 10A by not filling the declaration before the due date of return as provided on sub-section (8) of section 10A and, therefore, the provisions of section 10A are applicable in this case. On the contrary it has filed form No. 56F which shows that the assessee intended the applicability of the provisions of section 10A

In respect of a unit eligible for exemption u/s 10A, the profits are determined in terms of section 10A(1) and not in terms of section 28 and hence the said profits being loss is required to be ignored for the purpose of us carry forward and set off. In the absence computation where the profit is required to be excluded of taxable profits. The loss is also to be ignored and cannot be allowed to be carried forwards separately or in conjunction with any other loss, since the said loss is not a loss determined under the head profits and gains from business or profession

In Commissioner of Income-tax. Madrass Dhagarajan, 129 ITR 115 Hon'ble Madras High Court has held that the provisions of section 70 and 71 relating to set off of loss from one head against income from another contemplate loss from a source, the income from which is liable to tax. If income from a source is altogether exempt from tax, loss from that source cannot be set off against income from different source or income under at different head.

The situation can be illustrated by taking case of agricultural income. The agricultural income is exempt from tax. If a unit of an assessee is engaged in agriculture, and suffers a loss, such loss can never be adjusted income subject to taxation.

24.2. Accordingly, I do hereby disallow the losses to the tune of Rs. 222,288,862/-as referred above and increase the taxable income of the assessee by an equivalent amount on this ground.”

7.2 Aggrieved with the said order, the assessee filed objections before the Ld.

DRP.

7.3 The Ld. DRP rejected the objections of the assessee and its directions under section 144 C (5) of the Act are reproduced as under:

“The assessee has objected to AO's action in not allowing the losses incurred by the STPI units to be set off against other taxable incomes.

This contention of the assessee cannot be accepted as this matter is under litigation the department has not accepted the judgements wherein it has been held that the loss of the loss making units which are otherwise eligible for deduction u/s 10A of the IT Act will be allowed to be set off against other income of the assessee.”

7.4 The AO thereafter passed final assessment order disallowing the loss of Rs. 22,22, 88,862/-.

7.5 Aggrieved with the said order the assessee filed an appeal before us on the following grounds of the appeal:

5. That the assessing officer erred on facts and in law in not allowing set off of loss of the units / undertakings eligible for deduction under section 10A of the Act amounting to Rs.222,288,862 in respect of other taxable income in terms of sections 70 and 71 of the Act.

5.1. That the assessing officer erred on facts and in law in not appreciating that the provisions of section 10A of the Act were in the nature of deduction provision and not exemption provision.

5. 2. That the assessing officer erred on facts and in law in not appreciating that the loss computed in respect of undertakings eligible for deduction under section 10A of the Act is available for set off against other taxable income of the appellant in terms of sections 70 and 71 of the Act.

5.3. That the assessing officer erred on facts and in law in holding that in respect of a unit eligible for deduction under Section 10A of the Act, the profits are determined in terms of Section 10A (1) of the Act and not in the terms of Section 28 of the Act.

5.4. That the assessing officer erred on facts and in law in alternatively holding that the losses incurred by the undertaking eligible for deduction under section 10A of the Act would not be available for set off could not be set off as the appellant did not file declaration in terms of sub-section (8) of Section 10A of the Act.

5.5. That the Hon'ble DRP erred on facts and in law in upholding the proposed action of the learned AO of not allowing the set off of losses of the units/undertakings eligible for deduction under section 10A of the Act by merely concluding that the said issue is under litigation.”

7.6 In this regard, the assessee in its written submission, vide the chart submitted that the assessee computed deduction under section 10A of the Act,

without setting off the losses of the STP undertakings, from the profits of the undertakings covered under section 10A of the Act, and such losses were set off against the other taxable income of the assessee company. The assessee further submitted that according to the AO , in respect of a unit eligible for exemption u/s 10A of the Act, the profits are determined in terms of section 10A(1) and not in terms of section 28 and hence the said profits being loss is required to be ignored for the purpose of its carry forward and set off and in the absence in computation where the profit is required to be excluded of taxable profits, the loss was also to be ignored and could not be allowed to be carried forward separately or in conjunction with any other loss, since the said loss is not a loss determined under the head profits and gains from business or profession

7.7 In this regard, the assessee submitted that under the present scheme of the Act, the profits of the unit eligible for deduction under section 10A of the Act, would form part of the income computed under the head 'profits and gains of business or profession' and as a necessary corollary, losses of the STP unit cannot be ignored at the threshold. In this regard, the assessee placed reliance on the decision of the Hon'ble Bombay High Court in the case of Hindustan Unilever Ltd. vs DCIT: [2010] 325 ITR 102 (Bom) wherein the Court categorically held that loss of one of the four eligible units could be set off against the normal business income of the assessee. Further, the assessee referred to the observations of the Court

wherein it held that by Finance Act, 2000, the provisions of section 10B are no longer in the nature of exemption but are in the nature of deduction and therefore loss of one of the four eligible units could be set-off against the normal business income of the assessee. In this regard, the relevant findings of the Hon'ble Bombay Court as relied by the assessee are reproduced as under:

"24. There is merit in the submission which has been urged on behalf of the assessee that the Assessing Officer has while re-opening the assessment ex facie proceeded on the erroneous premise that Section 10B is a provision in the nature of an exemption. Plainly, Section 10B as it stands is not a provision in the nature of an exemption but provides for a deduction. Section 10B was substituted by the Finance Act of 2000 with effect from 1 April 2001. Prior to the substitution of the provision, the earlier provision stipulated that any profits and gains derived by an assessee from a 100 per cent Export Oriented Undertaking, to which the section applies "shall not be included in the total income of the assessee". The provision, therefore, as it earlier stood was in the nature of an exemption. After the substitution of Section 10B by the Finance Act of 2000, the provision as it now stands provides for a deduction of such profits and gains as are derived by a 100 per cent Export Oriented Undertaking from the export of articles or things or computer software for ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce. Consequently, it is evident that the basis on which the assessment has sought to be reopened is belied by a plain reading of the provision. The Assessing Officer was plainly in error in proceeding on the basis that because the income is exempted, the loss was not allowable. All the four units of the assessee were eligible under Section 10B. Three units had returned a profit during the course of the assessment year, while the Crab Stick unit had returned a loss. The assessee was entitled to a deduction in respect of the profits of the three eligible units while the loss sustained by the fourth unit could be set off against the normal business income. In these circumstances, the basis on which the assessment is sought to be reopened is contrary to the plain language of Section 10B"

(emphasis supplied by us)

7.8 It was further submitted that the aforesaid decision was relied upon and followed by the Hon'ble Karnataka High Court in the case of CIT vs Yokogawa India Ltd: [2012] 341 ITR 385 (Kar) wherein the Court, after recording aforesaid

extracts from the decision of the Bombay High Court categorically held that the principles laid down therein equally applied to a case falling under section 10A of the Act, subject of consideration before the Court and reproduced the relevant observations of the Hon'ble Karnataka High Court in its written submission which are reproduced hereunder:

"26. In fact, the Bombay High Court in the case of Hindustan Unilever Lid vs. Dy. CIT and Anr. (2011) 237 CTR (Bom) 287: (2010) 38 DTR (Bom) 91 (2010) 325 ITR 102 (Bom) incorporating s. 10B as amended held as under:

"Section 10B as it stands is not a provision in the nature of an exemption but provides for a deduction. Section 10B was substituted by the Finance Act of 2000 with effect from 1 April 2001. Prior to the substitution of the provision, the earlier provision stipulated that any profits and gains derived by an assessee from a 100 per cent Export Oriented Undertaking, to which the section applies "shall not be included in the total income of the assessee". The provision, therefore, as it earlier stood was in the nature of an exemption. After the substitution of Section 10B by the Finance Act of 2000, the provision as it now stands provides for a deduction of such profits and gains as are derived by a 100 per cent Export Oriented Undertaking from the export of articles or things or computer software for ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce. Consequently, it is evident that the basis on which the assessment has sought to be reopened is belied by a plain reading of the provision. The Assessing Officer was plainly in error in proceeding on the basis that because the income is exempted, the loss was not allowable. All the four units of the assessee were eligible under Section 10B. Three units had returned a profit during the course of the assessment year, while the Crab Stick unit had returned a loss. The assessee was entitled to a deduction in respect of the profits of the three eligible units while the loss sustained by the fourth unit could be set off against the normal business income, In these circumstances, the basis on which the assessment is sought to be reopened is contrary to the plain language of Section 10B."

27. The aforesaid principle equally applies to a case falling under Section 10-A of the Act"

(emphasis supplied by us)

7.9 It was further submitted that in further appeal filed by the Revenue, the Hon'ble Supreme Court in the case of CIT vs Yokogawa India Ltd: 391 ITR 274

(SC) held that after amendment of section 10A by Finance Act 2000 with effect from 1-4-2001, section 10A is a provision for deduction.

7.10 Further, the assessee also relied upon CBDT Circular No. 7/2013 dated 16.07.2013 which states "...that irrespective of their continued placement in Chapter III, sections 10A and 10B as substituted by Finance Act, 2000 provide for deduction of the profits and gains derived from the export of articles or things or computer software".

7.11 Further, it was submitted that the aforesaid Circular, too, clearly provides that tax benefit under section 10B of the Act is in the nature of "deduction" and the Circular further clarified that income/loss from various sources, i.e. eligible and ineligible units, under the same head have to be aggregated in accordance with the provisions of section 70 of the Act, meaning thereby that loss from any eligible unit would have to be set off against the profits of the non-eligible unit.

7.12 Further, it was submitted that the Co-ordinate Bench of the Tribunal in the case of NEC HCL System Technologies Ltd vs ACIT: [2017] 176 TTJ 436 (Del Trib.) held as under:

"13. Earlier to the above circular, it has been held by Honourable Bombay high court in case of Hindustan lever Limited V DCIT 325 ITR 102 (Bom) that loss in eligible unit could be set off against the profits of the business. It is also noted in the circular at para No. one that It has been brought to the notice of the Board that the provisions of 10A/10AA/10B/10BA of the Income-tax Act, with regard to applicability of Chapter IV of the Act and set off and carry forward of losses, are being interpreted differently by the Officers of the Department as well as by different High Courts. Therefore, it cannot be

said that circular is against the provision of the law merely because different high courts have interpreted the law differently. It is apparent that this circular is issued with an intention to clarify anomaly in law and its interpretation. Undoubtedly circular is beneficial to the assessee as it sets certain controversy involved therein to rest. Therefore we are of the opinion that this issue now should be decided in view of the above circular where in it is provided that If after aggregation of income in accordance with the provisions of sections 70 and 71 of the Act, the resultant amount is a loss (pertaining to assessment year 2001-02 and any subsequent year) from eligible unit it shall be eligible for carry forward and set off in accordance with the provisions of section 72 of the Act. Therefore, according to us assessee's claim deserves to be considered favourably in view of the beneficial circular issued by CBDT. However, at the time of making assessment AO was not having the privilege of this circular, we set aside this matter to the file of with direction to grant benefit of deduction of set off of losses of STPI unit of Rs 54,90,557/- against the profit of non- STPI unit in accordance with this circular.”

7.13 Further, the relevant extract of the Circular No. 7/2013 dated 16.07.2013 of the CBDT at page no. 435 in para no. 5.3 is reproduced as under:

“5.3 If after aggregation of income in accordance with the provisions of sections 70 and 71 of the Act, the resultant amount is a loss (pertaining to assessment year 2001-02 and any subsequent year) from eligible unit it shall be eligible for carry forward and set off in accordance with the provisions of section 72 of the Act. Similarly, if there is a loss from an ineligible unit, it shall be carried forward and may be set off against the profits of eligible unit or ineligible unit as the case may be, in accordance with the provisions of section 72 of the Act.”

(emphasis supplied by us)

7.14 The Special Counsel relied upon the orders of the authorities below.

7.15 We have heard both the parties and perused the material available on record. The assessee has relied upon the decision of the Hon’ble Apex Court in the case of CIT vs. Yokogawa India Ltd. 391 ITR 274 (SC), which has held that after amendment of section 10A by Finance Act 2000 with effect from 1-4-2001, section

10A is a provision for deduction. Further, in view of the Board's Circular No. 7 dated 16.07.2013 and the decision of the Hon'ble Bombay High Court in the case of Hindustan Unilever vs. DCIT (supra) and of Hon'ble Karnataka High Court in the case of CIT vs. Yokogawa India Ltd. (supra), we hold that the assessee is eligible to set off of losses amounting to Rs. 22,22,88,862/- crores in respect of the undertaking eligible under section 10A of the Act with other non-eligible unit/other taxable income. We therefore, accordingly, direct the AO to allow the set of losses amounting to Rs. 22,22,88,862/- crores against other taxable income, after due verification. Ground no. 5 to 5.5 of the appeal are allowed.

8. Ground no. 6 to 6.2 of the appeal are against the disallowance of depreciation on certain networking equipment / peripherals forming part of the "Computer System" and allowing the depreciation on the said items @ 25% by holding the same to be in the nature of "Plant & Machinery".

8.1 It was noticed by the AO that during the year, the assessee had claimed depreciation on certain items such as switches, cables, software tools, ports, adaptors, racks, boxes etc. as "Computers". The assessee was asked by the AO to explain as to why these items should not be treated as Plant & Machinery and accordingly, why the depreciation on these items should not be allowed @ 25% instead of @ 60% claimed by the assessee in the return of income. After considering the explanation of the assessee the AO held that the assessee was

entitled for depreciation @ 25% as against 60% claimed by the assessee. The relevant findings of the AO in the draft assessment order are reproduced as under:

“25. It was noticed that assessee had claimed depreciation on certain items such switches, cables, software tools, ports, adaptors, racks, boxes etc. as "Computers". The assessee was asked to explain as to why these items should not be treated as Plant & Machinery and accordingly, why the depreciation on these items should not be allowed @ 25% instead of @ 60% claimed by the assessee in the return of income.

A detailed reply was furnished by the assessee in support of depreciation claimed @ 60%. As per the reply filed by the assessee, all the underlying items, being capitalized by the assessee in its books under the head "Computers" do form an integral part of the Computer system as a whole.

I do not find any merit in the contention of the assessee. If the contention of the assessee is presumed to be correct, all the items connected with the Computers directly or indirectly, should be treated as "Computers" only which is patently incorrect. Accordingly, depreciation on all these items is liable to be allowed 25% only as compared to 60%

Details of depreciation claimed on Computer Peripherals by treating the same as Computers" 60% is as under:

<i>Assets used for 180 days or more</i>	<i>Rs. 3,70,78,718/-</i>
<i>Assets used for less than 180 days.</i>	<i><u>Rs. 4,32,04,290/-</u></i>
<i>Total</i>	<i><u>Rs. 8,02,83,008/-</u></i>

Depreciation claimed on Assets put to use for more than 180 days.

<i>Dep. Claimed @ 60%</i>	<i>Rs. 2,22,47,231/-</i>
<i>Dep. Allowable @ 25%</i>	<i><u>Rs. 92,69,680/-</u></i>
<i>Dep. To be disallowed.</i>	<i><u>Rs. 1,29,77,551/-</u></i>

Dep. Claimed on Assets put to use for less than 180 days.

<i>Dep. Claimed @30%.</i>	<i><u>Rs. 1,29,61,287/-</u></i>
<i>Dep. Allowable @ 12.50%.</i>	<i><u>Rs. 54,00,536/-</u></i>
<i>Dep. To be disallowed:</i>	<i><u>Rs. 75,60,751/-</u></i>

Total excess depreciation amounting to Rs.2,05,38,302/- (Rs. 1,29,77,551/- plus Rs. 75,60,751/-), being calculated as above, is being disallowed and is added to the income of the assessee.”

8.2 Aggrieved with the said order, the assessee filed objections before the Ld.

DRP.

8.3 The Ld. DRP rejected the objections of the assessee and its directions under section 144 C (5) of the Act are reproduced as under:

“ (g) The next objection of the assessee is disallowance by the AO of depreciation claimed by the assessee on certain networking equipment / peripherals forming part of the 'Computer System' and allowing the depreciation on the said items @ 25% by holding the same to be in the nature of 'Plant and Machinery.

(h) Assessee's objection that the AO was wrong in allowing depreciation only at Rs. 15% in respect of the networking equipment/peripherals, against the assessee's claim of 60% depreciation because these items qualified as computers is to be rejected. The printers, UPS and network routers are not a necessary prerequisite for running the computer. These are the Items/gazettes which are run with the help of the computer not vice versa. Only those items/parts will qualify as computer for the purpose of depreciation which are necessary for running the computers.”

8.4 The AO thereafter passed final assessment order disallowing the excess depreciation of Rs. 2,05,38,302/- claimed by the assessee.

8.5 Aggrieved with the said order, the assessee is in appeal before us on the following grounds of the appeal :

6. That the assessing officer erred on facts and in law in disallowing depreciation to the extent of Rs.2,05,38,302 which appellant had claimed on certain networking

equipments / computer peripherals, covered under the Computers holding that the said items were eligible for depreciation as plant and machinery and not as computer.

6.1. That the assessing officer erred on facts and in law in making disallowance of depreciation claimed by the assessee @ 60% on certain networking equipments and computer peripherals, forming part of the "Computer System" and instead allowing the depreciation on the said items @ 25% holding the same to be in the nature of "Plant & Machinery"

6.2 That the Hon'ble DRP erred on facts and in law in upholding the proposed action of the learned AO of treating networking equipments / computer peripherals, covered under the Computers as being eligible for depreciation as plant and machinery and not as computer

8.6 In this regard, the assessee filed a written submission, which is reproduced as under:

“ The appellant in the relevant previous year claimed depreciation @ 60% on certain networking equipment and computer accessories and peripherals, such as, computer operating system, printer, monitor, memory card, RAM, RAM card, sound and graphic card modem, switch connecting cables, etc.

The assessing officer restricted the claim of depreciation on computer peripherals at 25% as against 60% claimed by the assessee holding the same to be a part of plant and machinery and accordingly made the disallowance to the extent of Rs.2,05,38,302.

This Hon'ble Tribunal in the case of HCL Technologies BPO Services Ltd vs ACIT: ITA No.5622/Del/2010 (Del Trib.), has held that assessee is entitled for depreciation of computer/ integral equipment's @ 60% as against 25% allowed by the AO, by relying on the decision of the Hon'ble Delhi High Court in the case of CIT vs BSES Rajdhani Powers Ltd: 1266/2010 (Del).

The aforesaid action of the assessing officer is unsustainable on account of following judicial precedents squarely applicable in favour of Appellant:

CIT vs Birlasoft Ltd.: SLP Nos. 20645/2012 (SC)

PCIT vs Nestle India Ltd: [2023] 457 ITR 216 (Del)

CIT vs Orient Ceramics and Inds Ltd.: 200 Taxman 64 (Del.)

CIT vs Citicorp Maruti Finance Ltd.: ITA 1712 and 1714/2010 (Del.)

CIT vs BSES Yamuna Powers Ltd.: ITA No. 1267/2010 (Del.)

CIT vs Orient Ceramics and Inds Ltd.: 65 & 66 of 2011 (Del.) (HC)

DCIT vs Data craft India Ltd.: 133 TTJ 377 (SB)

ITO Vs Samiran Majumdar: 98 ITD 119 (Kol.)

Container Corporation of India vs. ACIT: ITA No. 2851 & 3680/D/07

ACIT vs. Cincom Systems India: [ITA No. 1534 Delhi of 2008, dated 13-4-2009 (Delhi ITAT)

ACIT vs. Cargo Motors (P) Ltd: ITA No. 2900/D/08

ACIT vs. Citi Corp Maruti Financial Ltd: ITA No. 3749 & 3750/D/08

Climate Systems India Ltd. vs. ACIT: ITA No. 1698/D/08

Expeditors International India (P) Ltd. vs. ACIT: 118 TTJ 652

DCIT v. International Travel House ltd.: ITA No. 4135/Del/2013 (Del.)

DCIT v. Ushodaya Enterprises Ltd.: 155 ITD 701

Coil Company (P.) Ltd v ACIT: 65 SOT 27 (Delhi - Trib.)

DCIT v Mentor Graphics, (Noida) (P.) Ltd: IT Appeal No. 2634 (DELHI) OF 2011 (Delhi Trib)

ITO v Cryobanks International (I) (P.) Ltd.: 151 ITD 552 (Delhi - Trib.)

Casio India Co. (P.) Ltd v DCIT: 70 SOT 48 (Delhi - Trib.)”

8.7 On the other hand, the Special Counsel relied upon the order of the authorities below.

8.8 We have considered the rival submissions and perused the material available on record. On similar facts, the Hon’ble Delhi High Court in the case of CIT vs. BSES Rajdhani Power Limited (supra) has held that that the assessee is entitled for depreciation of computer / integral equipment @ 60% as against 25% allowed by the AO. The relevant extracts of the order are reproduced as under:

“2. Ms. Prem Lata Bansal, learned counsel for the Revenue submitted that the Tribunal had erred in law in allowing depreciation to the assessee at the higher rate of 60% on computer accessories and peripherals instead of the normal rate @

25%. She further submitted that the computer peripherals and accessories could not be treated at par with computer and computer software.

3. However, upon a perusal of the file, we find that the higher rate of depreciation was allowed both by the Commissioner of Income Tax (Appeals) "CIT(A)" and the Tribunal. In fact, the Tribunal in its impugned order has observed as under :-

"The issue involved in this appeal is covered by the decision of Coordinate of the Tribunal as discussed below:-

In the case of ITO vs. Samiran Majumdar (2006) 98 ITD 119 (Kol.), ITAT Tata Bench 'B', has taken a view that the printer and scanner are integral part of the computer system and are to be treated as computer for the purpose of allowing higher rate of depreciation, ie, 60%

3.2. The ITAT, Delhi 'F' Bench in the case of Expeditors International (India) (P) Ltd. Vs. Id. CIT reported in (2008) 118 TTJ 652 has held that peripherals such as printer, scanners, NT Server, etc. form integral part of the computer and the same, therefore, are eligible for depreciation at the rate of 60% as applicable to a computer.

4. Respectfully following the aforesaid decisions of the Coordinate Bench, we uphold the order of Id CIT(A) in allowing the depreciation at 60% on computer peripherals and accessories, and, thus, the ground raised by the revenue is rejected.

5.. In the result, the appeal filed by the revenue is dismissed."

4. We are in agreement with the view of the Tribunal that computer accessories and peripherals such as, printers, scanners and server etc. form an integral part of the computer system. In fact, the computer accessories and peripherals cannot be used without the computer. Consequently, as they are the part of the computer system, they are entitled to depreciation at the higher rate of 60%.

5. In view of aforesaid, present appeal is dismissed in limine."

(emphasis supplied by us)

8.9 Respectfully following the above judicial precedent, we direct the AO to allow depreciation on Computer/ integral equipment @ 60% as claimed by the assessee. Ground nos. 6 to 6.2 are allowed.

9. In ground nos. 7 to 7.2, the assessee has challenged the disallowance of expenses under section 14A of the Act by invoking the provisions of section 14A of the Act read with Rule 8D of the IT Rules, 1962.

9.1 Aggrieved with the said order, the assessee filed objections before the Ld. DRP.

9.2 The Ld. DRP rejected the objections of the assessee and its directions under section 144 C (5) of the Act are reproduced as under:

“ (d) The next objection of the assessee is against disallowance of Rs. 1,05,07,741/- made by the AO u/s 14A read with Rule 8D of the I.T. Rules. This objection of the assessee is rejected in view of the fact that the AO has computed the disallowance by application of Rule 8D as upheld by this Special Bench of the ITAT in the cases of Daga Capital Management (P) Ltd., 26 SOT 603 (MUM) (SB) and Cheminvest Ltd.”

9.3 The assessee filed a written submission and the relevant extract of the same are reproduced as under:

The appellant has in the relevant previous year earned the following income from treasury operations, i.e., from investments made in securities:

<i>Particular</i>	<i>Amount</i>
<i>Taxable Interest Income</i>	<i>94,64,311</i>
<i>Tax-free Interest Income [A]</i>	<i>1,94,21,916</i>
<i>Taxable Capital Gain (Net)</i>	<i>56,61,46,218</i>
<i>Dividend Income</i>	<i>2,39,16,605</i>

<i>[B]</i>		
Tax free income + <i>[B]</i>	<i>[A]</i>	4,33,38,521

The appellant in the relevant previous year earned aggregate amount of tax-free income of Rs.4,33,38,521. The appellant in the return of income computed disallowance under section 14A of the Act of Rs.3,78,396, being expenditure relatable to earning of such exempt income. Details of computation of suo motu disallowance under section 14A of the Act was submitted before the assessing officer vide reply dated 28.09.2009 and 18.11.2009. [Refer page no.426 of paper book]

The computation of suo-motu disallowance under section 14A of the Act made by the Appellant is as under:

Income attributable to treasury department	Exempt Income (in Rs.)	Non-exempt Income (in Rs.)	Total Income (in Rs.)
Dividend income	2,17,30,304		2,17,30,304
- On trade investment	21,86,301		21,86,301
- On Investment (other than trade)			
Interest income (On fixed deposits & investments)	1,94,21,916	94,64,311	2,88,86,227
Profit on sale of investment (other than trade)		56,96,27,051	56,96,27,051
Loss on sale of investment (other than trade)		(34,80,833)	(34,80,833)
Total	4,33,38,521	57,56,10,529	61,89,49,050

Expense attributable to treasury department = Rs.54,04,143 @ Page.426 of paper book.

Expenses attributable to exempt income = Total expenses * (Exempt Income/ Total Income) = Rs.3,78,396

The AO considered and accepted the computation of suo moto disallowance of treasury expenses by the Appellant. However, arbitrarily holding that disallowance is to be made in terms of Rule 8D of the Income-tax Rules, 1962 (“the Rules”) only, the AO recomputed the suo motu disallowance made by the Appellant. The AO recomputed disallowance under section 14A of the Act at Rs.95,41,773 as against Rs.3,78,396 suo-motu disallowed by the Appellant, arbitrarily invoking Rule 8D of the Rules. The computation of disallowance by the assessing officer invoking rule 8D of the Rules is as under:

Particulars	Amount (in Rs.)
Disallowance under Rule 8D(2)(i)	Nil
Disallowance under Rule 8D(2)(ii) Interest paid x total average investment/ total average asset	12,88,773
Disallowance under Rule 8D(2)(iii)	82,53,000
Total	95,41,773

Rule 8D of the Income-tax Rules, it is submitted, at the outset, being prospective and applicable from assessment year 2008-09, does not apply in the relevant year [refer CIT vs Essar Teleholdings Ltd: [2018] 401 ITR 445 (SC); PCIT vs Reliance Natural Resources Lt: [2022] 286 Taxman 435 (SC)].

9.4 We have heard both the parties and perused the material available on record. We have perused the decision of the Hon’ble Apex Court in the case of CIT vs Essar Teleholdings Ltd (supra); PCIT vs Reliance Natural Resources Ltd. (supra), which held that Rule 8D is prospective in operation and could not have been applied to any assessment year prior to Assessment Year 2008-09 and therefore, the same will not be applicable for the present assessment year in the case of the assessee. The relevant observation of the Hon’ble Apex Court in the case of CIT vs Essar Teleholdings Ltd (supra) is reproduced in para no. 49 and 50 (page 458 of

the P.B.) as under:

“49. It is relevant to note that impugned judgment in this appeal relies on earlier judgment of Bombay High Court in Godrej and Boyce Manufacturing Company Limited versus Deputy Commissioner of Income Tax, Mumbai and Another, (2017) 7 SCC 421, where the Division Bench of the Bombay High court after elaborately considering the principles to determine the prospectivity or retrospectivity of the amendment has concluded that Rule 8D is prospective in nature. Against the aforesaid judgment of the Bombay High court dated 12.08.2010 an appeal was filed in this court which has been decided by vide its judgment reported in Godrej and Boyce Manufacturing Company Limited Vs. Deputy Commissioner of Income Tax, Mumbai & Anr. (2017) 7 SCC 421. This Court, while deciding the above appeal repelled the challenge raised by the assessee regarding vires of Section 14A. In para 36 of the judgment, this Court noticed that with regard to retrospectivity of provisions Revenue had filed appeal, hence the said question was not gone into the aforesaid appeal. In the above case, this Court specifically left the question of retrospectivity to be decided in other appeals filed by the Revenue. We thus have proceeded to decide the question of retrospectivity of Rule 8D in these appeals.

50. In view of our opinion as expressed above, dismissal of the appeal by the Bombay High Court is fully sustainable. As held above, the Rule 8D is prospective in operation and could not have been applied to any assessment year prior to Assessment Year 2008-09.”

9.5 Respectfully following the above decision, we hold that the disallowance of Rs. 91,63,377/- is not sustainable and the same is deleted.

10. In ground no. 8 to 8.1, the assessee has challenged the disallowance of deduction u/s 10A of the Act, in respect of branch profits of erstwhile DSL Software Limited. The Assessing Officer held that while computing deduction under section 10A of the Act in respect of profit from onsite software services rendered by units of the DSL (subsequently merged into the assessee), profit/loss relatable to overseas branches do not qualify to be included for computing

deduction under the said section. The relevant findings in the draft assessment order are reproduced as under:

“ 27. The erstwhile DSL Software Limited was having three foreign branches located in U.S.A., U.K. and Singapore. Pursuant to amalgamation effected during the assessment year under consideration, these foreign branches have now become branches of the assessee company.

The assessee company was asked to explain as to why deduction u/s 10A should not be disallowed in respect of the branch profits as it was done in the last AY 2005-06 in view of the fact that the branch operations represent technical services in nature and as such, there has been no export of computer software from India. A detailed reply was filed by the assessee

I do not agree with the contentions of the assessee company. Further, as explained by the assessee, the underlying foreign branches do perform their operations under overall control and supervision of the undertakings in India and as such, the operations performed by the said branches do form an integral part and parcel of the undertakings in India.

If one goes by the said contention of the assessee, it is clearly evident that the undertakings in India are dependent on the foreign branches for performing the operations outside India and if this is so, it is contrary to the own contention of the assessee that an undertaking means a unit of business venture which is capable of functioning at its own. It is thus clearly established that there is no merit in the contentions of the assessee regarding the eligibility of the profits of the foreign branches of the assessee company for claiming deduction under Section 10A of the Act.

As a result, as discussed in detail in the assessment orders for the earlier assessment years, the following profits/ (losses) of the below mentioned foreign branches for the assessment year under consideration are not being considered for the purpose of allowing deduction u/s 10A of the Act to the undertakings earlier owned by erstwhile DSL Software Limited:-

(emphasis supplied by us)

Location of Foreign Branch	Revenues	Expenses	Net Profit/(Losses)
U.S.A.	17,35,70,341	21,29,67,415	(3,93,97,074)
U.K.	24,33,90,590	28,77,67,592	(4,43,77,00)
Singapore	13,50,57,926	14,48,36,716	(97,78,789)

10.1 Aggrieved with the said order, the assessee filed objections before the Ld. DRP.

10.2 The Ld. DRP rejected the objections of the assessee and its directions under section 144 C (5) of the Act are reproduced as under:

“7. Assessee has objected to disallowance of deduction u/s 10A of the Act in respect of branch profit of erstwhile DSL Software Ltd. This objection of the assessee cannot be accepted. We agree with the reasoning of the AO that the profits/loss deletable to overseas branched does not qualify to be included for deduction u/s 10A of the Act.”

10.3 The AO thereafter passed the final assessment order disallowing the loss relatable to its overseas branches DSL.

10.4 Aggrieved with the said order, the assessee has filed an appeal before us on the following grounds of appeal:

8. That the assessing officer erred on facts and in law in arbitrarily concluding that the onsite software development operations performed by the appellant through foreign branches of the erstwhile DSL Software Limited, which are now amalgamated with the appellant in the year under consideration, don't form an integral part of the undertakings of the appellant being eligible for deduction under Section 10A of the Act.

8.1. That the assessing officer erred on facts and in law in arbitrarily concluding that the branch operations are technical services in nature and as such, there has been no export of computer software from India without appreciating the contentions made by the appellant in the course of impugned assessment proceedings.

10.5 In this regard, the Ld. AR filed a written submission, which is reproduced as under:

“DSL Software Limited (subsequently merged into the Appellant) was having three units in operation and had branches in overseas locations at US, UK and Singapore to facilitate onsite operations on account of regular requirement of obtaining work permits/ visa for employees travelling abroad for performing onsite services. In view of the regulatory requirements relating to work permits, etc., employees deputed on overseas locations for rendering onsite services are shown as part of the branches in those countries and the profit/ loss from the onsite operations so performed by these overseas branches are accounted for as profit/ loss of the overseas branches.

For undertaking onsite services in respect of various software development projects by the various units, the employees are deputed to the overseas locations, viz., Singapore, US and UK. In view of the regulatory requirement for obtaining work permits/ visa for such employees deputed on onsite projects, the assessee is required to have a physical presence, inter alia, in the form of branch in these countries. The assessee has accordingly established branches at Singapore, USA and UK.

DSL (subsequently merged into the Appellant), for the limited purpose of complying with Transfer Pricing Regulations and for discharging its statutory onus of filing return of income in respect of such branches in the respective countries, considers the revenue from such onsite services, as revenue of the branch and salaries of the employees, deputed on onsite projects, is considered as the expenditure of the respective branch. In the books of accounts, however, the revenue in respect of onsite operations relating to each project is identified with the respective undertaking and profit in relation to such onsite services, is accounted as part of overall profits of the concerned undertaking.

During the relevant previous year, the profits of aforesaid branches were claimed as deduction under section 10A of the Act.

The assessing officer while computing deduction under section 10A of the Act in respect of profit from onsite software services rendered by units of the DSL (subsequently merged into the Appellant), held that profit/ loss relatable to overseas branches does not qualify to be included for computing deduction under the said section.

The assessing officer held as under:

- (i) The underlying foreign branches do perform their operations under overall control and supervision of the undertakings in India and as such, the operations performed by the said branches do form an integral part and parcel of the undertakings in India.*
- (ii) If one goes by the said contention of the assessee, it is clearly evident that the undertakings in India are dependent on the foreign branches for performing the operations outside India and if this is so, it is contrary to the own contention of the assessee that an undertaking means a unit or business venture which is capable of functioning at its own.*

Computation of deduction under section 10A as made by the assessing officer, in our respectful submission, is not in accordance with the scheme of the Act for the reasons submitted hereunder:

Section 10A of the Act provides for deduction in respect of profits and gains derived by an undertaking established, inter alia, in Software Technology Park from export of computer software. The said section provides for fiscal incentive for promoting export of computer software.

Explanation (Explanation 3) was inserted to section 10A of the Act by the Finance Act, 2001, which reads as follows:

***“Explanation 3.**-For the removal of doubts, it is hereby declared that the profits and gains derived from on site development of computer software (including services for development of software) outside India shall be deemed to be the profits and gains derived from the export of computer software outside India.”*

Similar Explanation was introduced by the Finance Act, 2001 to sub-section (1) of section 80HHE of the Act, to clarify that the profits derived from onsite development of computer software shall be deemed to be profits and gains derived from export of computer software outside India. Explanation to sub-section (1) of section 80HHE of the Act reads as under:

“Explanation . - For the removal of doubts, it is hereby declared that the profits and gains derived from on site development of computer software (including services for development of software) outside India shall be deemed to be the profits and gains

derived from the export of computer software outside India.”

It would be appreciated that the said Explanation was inserted to clarify the existing legislative intent that the benefit of deduction under section 10A/ 80HHE of the Act, shall be admissible in respect of onsite development of computer software including onsite software services.

The Explanatory Note on the Finance (No.2) Act, 1991 issued by the CBDT (vide circular No. 621 dated 19-12-1991) while explaining the scope of deduction provided in the newly inserted section 80HHE of the Act providing fiscal incentives for promoting export of computer software clarified as under:

“Tax concessions for the export of computer software and for import of system software

34. With a view to providing fiscal incentive for promoting export of computer software, a new section 80HHE has been inserted in the income-tax Act for providing tax concessions similar to those available under section 80HHC of the Income-tax Act in relation to commodity exports.

34.1 Under the new provisions, Indian companies and resident non-corporate taxpayers will be eligible for a deduction, in computing their taxable income, of an amount equal to the profits derived from export of computer software.

34.2 The broad features of the new provision are as under:

(i) The tax concession will be available with regard to profits from export of software not only through magnetic media or on paper but also through satellite data link and consultancy delivered at the location of foreign client outside India.

xxx

xxx

xxx

xxx

xxx

(iv) The tax concession will be available with reference to export profits derived during the financial years 1990-91, 1991-92 and 1992-93 relevant to assessment years 1991-92, 1992-93 and 1993-94 respectively.

34.8 This amendment takes effect from 1st April, 1991, and accordingly, will apply in relation to assessment year 1991-92 and subsequent assessment years.”

It would be appreciated that the legislative intent since the inception was to provide the fiscal incentive in the form of section 80HHE of the Act in respect of export of software not only through magnetic media or of paper, but also through Satellite data link and consultancy delivered at the location of the foreign client outside India.

The assessee, it is respectfully submitted, has various software units/ undertakings which are eligible for deduction under section 10A of the Act. The assessee has also branches in the various countries, viz., US, UK and Singapore. The aforesaid branches, in our respectful submission, were established with the permission of RBI, to provide onsite support for executing contracts for export of computer software, by the undertakings located in India.

The branch per se being part of the assessee company does not constitute a separate legal entity. It would be appreciated that revenues from onsite services are notionally taken into account for determining profit of the branches merely for transfer pricing purposes.

In the books of accounts maintained by the assessee, these revenues and costs of the overseas branches are linked with the concerned software development projects executed from the undertakings in India and are ultimately reported as the revenues and the costs of the concerned undertakings.

The overseas branches of the assessee merely constitute conduit for rendering of onsite software development services in relation to software development projects undertaken by the various undertakings located in India. The profits of such branches is essentially profit derived from onsite software development services and is clearly covered by Explanation 3 to section 10A of the Act and accordingly qualify for deduction under that section.

CBDT Circular No. 694, DATED 23.11.1994 in this regard, clarifies the position as under:

“

DEVELOPMENT OF PROGRAMMES ON-SITE

Since computer programmes are not physical goods but are developed as a result of an intellectual analysis of the systems and methods followed by the purchaser of the programme, it is often prepared on-site, with the software personnel going to the client's premises. Doubts have been raised whether units taking up such production of software at the client's premises would be eligible for the tax holiday.

The Government's policy on tax incentive to software exports is reflected in the provisions of section 80HHE introduced in 1991. Under this provision, technical services provided outside India, for the development or production of computer software, are included for the purpose of the tax incentive.

Similarly, for the purpose of section 10A or 10B, as long as a unit in the EPZ/EOU/STP itself produces computer programmes and exports them, it should not matter whether the programme is actually written within the premises of the unit. It is, accordingly, clarified that, where a unit in the EPZ/EOU/STP develops software sur place, that is, at the client's site abroad, such unit should not be denied the tax holiday under section 10A or 10B on the ground that it was prepared on-site, as long as the software is a product of the unit, i.e., it is produced by the unit.

.....”

(emphasis supplied)

CBDT issued another clarification by way of **Circular No. 1/2013 [F. NO. 178/84/2012-ITA.I]**, DATED 17.01.2013, the relevant extract of which is as under:

“.....

(i) (a) Whether "on-Site" development of Computer Software Qualifies as an extort activity for tax benefits under sections 10A, 10AA and 10B of the Income-tax Act, 1961; And

(b) Whether receipts from deputation or Technical Manpower for such "On-Site" Software development abroad at the Client's place are eligible for deduction under sections 10A, 10AA and 10B.

(a) CBDT had earlier issued a Circular (Circular No. 694, dated 23-11-1994) which provided that a unit should not be denied tax-holiday under section 10A or 10B on the ground that the computer software was prepared 'on-site', as long as it was a product of the unit, i.e., it is produced by the Unit. However, certain doubts appear to have arisen following the insertion of Explanation 3 to sections 10A and 10B (vide Finance Act, 2001) and Explanation 2 to section 10AA (vide Special Economic Zones Act, 2005) providing that "the profits and gains derived from on site development of computer software (including services for development of software) outside India shall be deemed to be the profits and gains derived from the export of computer software outside India", and a clarification has been sought on the impact of the Explanation on the tax-benefits as compared to the situation that existed prior to the amendments.

*The matter has been examined. In view of the position of law as it stands now, it is clarified that the **software developed abroad at a client's place would be eligible for benefits under the respective provisions, because these would amount to 'deemed export' and tax benefits would not be denied merely on this ground. However, since the benefits under these provisions can be availed of only by the units or undertakings set up under specified schemes in India, it is necessary that there must exist a direct and intimate nexus or connection of development of software done abroad with the eligible units set up in India and such development of software should be pursuant to a contract between the client and the eligible unit.** To this extent, Circular No. 694, dated 23-11-1994 stands further clarified.*

(emphasis supplied)

*Reference may also be made to the decision of Delhi Bench of Tribunal in the case of **DCIT vs Interra Software India (P) Ltd: 112 TTJ 982 (Del Trib.)**, wherein it has been held that profits derived from a foreign branch from onsite services for development of computer software is covered in Explanation 3 to section 10A of the Act, (pari materia to Explanation 2 to section 10AA), so as to be eligible for deduction under that section. The relevant extract of the decision is as follows:*

"10. The last ground in this appeal relates to the action of the CIT (Appeals) in setting aside the action of the Assessing Officer in denying exemption under section 10A with respect to a sum of Rs. 18,51,545 representing the profits earned by the assessee from its Japan Branch. We find that the Assessing Officer in the assessment order has denied the claim of the assessee on the ground that the provisions of section 10A do not cover the profits of a foreign branch of the assessee. The CIT (Appeals) however has allowed the claim of the assessee on the basis of the Explanation 3 to section 10A of the Act. In para 6.3 of her order, the CIT (Appeals) makes the following discussion:

"6.3 There is no doubt as per Explanation 3 to section 10A as noted above the profits and gains derived from onsite development of computer software including services of development of software outside India is deemed to be profits & gains derived from the export of computers software outside India with effect from 1-4-2001. There is no doubt the Japan branch has been opened by the appellant as per the agreement with the Japanese company to also provide onsite development service, with the approval of RBI and also noted by Noida Special Economic Zone that the appellant unit located at NSEZ has opened a new trading branch at Tokyo. Therefore, the profits derived by the appellant company from its Japan Branch in reference to

the onsite services provided qualify for exemption under section 10A of the Income-tax Act and the Assessing Officer is directed to consider the same as exempt under section 10A of the Act."

Against the aforesaid, the Revenue is in appeal before us.

11. The learned DR, apart from placing reliance on the order of the Assessing Officer, has not made any cogent arguments to rebut the inference drawn by the CIT (Appeals) on this issue. The stand of the assessee before us is merely in support of the aforesaid conclusion drawn by the CIT (Appeals).

*12. In this connection, we have perused the relevant provisions and find that the claim of the assessee has been rightly allowed by the CIT (Appeals). **Explanation 3 to section 10A permits exemption under section 10A on the profits derived by an assessee from a foreign branch with reference to onsite services for development of computer software provided by the said company. In this light, the CIT (Appeals) factually found the assessee to be eligible for the exemption under section 10A in relation to the profits derived by the Japan Branch. There is nothing to controvert the aforesaid finding of the CIT (Appeals) before us. We, therefore, affirm the conclusion drawn by the CIT (Appeals) on this issue."***

(emphasis supplied)

*In appeal against the aforesaid decision of the Tribunal, the **Delhi High Court** in the case reported as **CIT vs Interra Software (P) Ltd: 238 CTR 23 (Del)**, held that the deduction under section 10A/ 10B of the Act would not be admissible in respect of profit of the branches engaged in marketing activities, etc. However, where the overseas branch is engaged in rendering onsite services and acts as a liaison office, i.e., a pass through entity for co-ordination between the software development undertaken in India and the customer for rendering such on-site services, profit of such overseas branch shall be eligible for deduction under section 10A/10B of the Act. The relevant extract of the decision is as under:*

"10. As per this Explanation, even if the profits and gains derived from on site development of computer software outside India, they are also treated as profits and gains from the export of computer software outside India. In the backdrop of this provision, what is to be examined is as to whether Japan office of the assessee would be treated as an onsite development of computer software or it is to be treated as separate branch functioning independently.

11. As noted above, the submission of learned counsel for the Revenue is that to qualify the “on site development”, it should be only a Liaison Office acting as an intermediary between the foreign principal enterprise and the India customers and vice-versa. Wherever, such foreign office is working as a separate branch carrying on full-fledged marketing operations that would not be treated as on site development.

12. We are in agreement with this interpretation suggested by learned counsel for the Revenue. However, what we find from the record that matter is not examined in this perspective by the authorities below.....”
(emphasis supplied)

Further reliance is placed on the decision of Delhi Bench of the Tribunal in the case of DSL Software Ltd vs ACIT: ITA No.3722/Del/2014 , wherein on similar facts, the Tribunal upheld the order of CIT(A) allowing the claim of assessee under section 10A of the Act in respect of profit earned by the overseas branches from onsite development services holding the same to be covered by Explanation 3 of the said section. The relevant extract of the Tribunal’s order is as under:

“11. We have heard the rival submissions and have gone through the entire material available on record. We find that the Id. CIT(A) has given cogent reasons on the issues under consideration, which could not properly controverted on behalf of the Revenue. For ready reference, the findings of the Id. CIT(A) are reproduced as under :

“2.1 I have considered the facts stated by the assessee in his submission and the grounds raised in appeal.

.....

2.9 The decision of the Delhi Bench of the Tribunal in the case of Interra Software India Pvt. Ltd., relied upon by the appellant, has recently been adjudicated by the Hon’ble Delhi High Court vide their order dated 24-12- 2010 in ITA Nos. 507 of 2008 and 160 of 2009. The relevant portions of the decision of the Hon’ble Delhi High Court are reproduced as under:

.....

2.10 In view of the afore said finding of the Hon’ble Delhi High Court, it was required to examine, whether branch offices in Singapore, USA and UK, created by the appellant, operate as liaison offices for rendering on-site services or such branches are engaged in rendering marketing services.....

.....

2.13 In view of the aforesaid facts, which are on record, I am of the view that the overseas branches of the appellant merely act as conduit for rendering of the onsite software development services in relation to software development projects undertaken by the various undertakings located in India. The aforesaid profits of the branches do satisfy the test laid down by the Hon'ble Delhi High Court in the case of Interra Software India Pvt. Ltd., in as much as the overseas branches of the appellant are acting merely as conduit for rendering on site services. The profits of such branches aggregating to Rs. 9,79,43,206/- being essentially in the nature of profits derived by the appellant from onsite software development services, is apparently covered by Explanation 3 of Section 10A of the Act and would accordingly qualify for deduction under that Section. Ground No. 2 & 3 are hereby allowed.

12. There being no contrary material on record to rebut the aforesaid findings of Id. CIT(A), we do not find any merit in the appeal of the Revenue. Accordingly, this appeal of the Revenue also deserves to be dismissed."

It is respectfully submitted, therefore, that in terms of Explanation 3 to section 10A, the assessee is eligible for deduction under section 10A on onsite operations undertaken through its branches, following the ratio laid down by Courts and Tribunals."

10.6 On the other hand, the Ld. Spl. Counsel relied upon the orders of the authorities below.

10.7 We have heard both the parties and perused the material available on record. Similar issue came up in the case of the assessee for A.Y. 2004-05, wherein, the Co-ordinate Bench of the Tribunal vide its common order dated 30.04.2019 in DCIT Central Circle-2, New Delhi vs. DSL Software Ltd. (now amalgamated with HCL Technologies Ltd.) in ITA No.- 3722/Del/2014 & 3723/Del/2014 for A.Y. 2002-03 and 2005-06 had allowed the claim of the assessee for A.Y. 2005-06 after

noting the findings of fact arrived by the Ld. CIT(A) that the overseas branches of the assessee was merely acting as conduit for rendering of onsite software development services in relation to software development projects undertaken by the various undertakings located in India. The relevant extract regarding the finding of the Ld. CIT(A) is reproduced as under:

“ 2.10 In view of the afore said finding of the Hon'ble Delhi High Court, it was required to examine, whether branch offices in Singapore, USA and UK. created by the appellant, operate as liaison offices for rendering on-site services or such branches are engaged in rendering marketing services. During the appellate proceedings, the appellant has submitted the following papers and documents to demonstrate that the overseas branches of the appellant at Singapore, UK and USA are solely engaged in rendering of on-site software development services:-

(v) Master Service Agreement with Deutsche Bank, AG.

(vi) Project-wise Details of software development services (offshore and onsite) in respect of GNR Unit

(iii) SOFTEX Form/return submitted with STPI.

2.11 It, therefore, cannot be disputed that onsite services rendered by the appellant are essentially services for development of software or are onsite services rendered in connection with software development operations performed by the appellant in the software development centers in India.

Moreover from para 2 at page 1 of the impugned assessment order too, it is observed that the assessing officer has not disputed the fact that the appellant is developing and supplying software only. The assessing officer, however, was of the view that there is an element of "technical services" involved in such activity and accordingly held that the appellant was engaged in the business of providing technical services at the customer's location through it's overseas branches.

2.12 further, the Hon'ble Delhi Bench of the Tribunal vide order dated 23.01.2009 in appellants 's own case for assessment year 2004-05 (ITA Nos. 3199 & 3344/Del/07) has while reversing the action of the Assessing Officer rendering technical services outside India [which was reduced to 10% by in holding 60% of the expenditure incurred in foreign currency was for the CIT (A)] held as under:

QUOTE

technical services outside India. However, while concluding his finding. 5. From perusal of this finding, it reveals that CIT (Appeals) has principally agreed with the contentions of the assessee that it was not providing expenses attributable for providing

technical services outside India. The AO somehow he estimated 10% of software development charges towards has totally misconstrued the activities of the assessee from its website. The assessee was not providing any technical services and there is no material brought on record by the assessing officer which can exhibiting that it was providing technical services. There are no receipt under that head. If the assessee was in the business of providing consultancy services, then assessing officer could have lay his hands on some agreement executed between the assessee and the entity who availed the consultancy charges. The assessing officer could also investigate from the receipts whether these were received by the assessee in lieu of any consultancy agreement or they are related to export of software developed by it. In view of the above, we do not find any justification in allocating a particular percentage of software development charges towards expenses alleged to have been incurred for providing technical services. We allow this ground of appeal raised by the assessee and reject the ground of appeal raised by the revenue. We direct the assessing officer not to exclude any amount from software development charges under the garb of expenses incurred, towards providing consultancy services. He will not exclude these amounts from the export turnover while computing the deduction admissible under section 10A of the Act."

UNQUOTE

To 'similar effect is the finding of the 'Hon'ble' Tribunal' in the case of the appellant for assessment years 2004-05 in ITA Nos. 3203 & 3204/Del/07, wherein relying upon the earlier decision of the Tribunal for assessment year 2003-04 (in ITA Nos. 1320 & 1448/D/08), the contentions of the assessee were upheld.

2.13 In view of the aforesaid findings by the Hon'ble Tribunal, too, the activities of the appellant are to be regarded as that of developing and supplying software and the overseas branches of the appellant, cannot be deemed to be engaged in any activity other than rendering software development services (on-site services) only.

In view of the aforesaid facts, which are on record, I am of the view that the overseas branches of the appellant merely act as conduit for rendering of the onsite software development services in relation to software development projects undertaken by the various undertakings located in India. The aforesaid profits of the branches do satisfy the test laid down by the Hon'ble Delhi High Court in the case of Interra Software India Pvt. Ltd. in as much as the overseas branches of the appellant are acting merely as conduit for rendering on site services. The profits of such branches aggregating to Rs. 9,79,43,206/- being essentially in the nature of profits derived by the appellant from onsite software development services, Is apparently covered by Explanation 3 of Section 10A of the Act and would accordingly qualify for deduction under that Section. Ground No. 2 8s 3 are hereby allowed.

12. There being no contrary material on record to rebut the aforesaid findings of Id. CIT(A), we do not find any merit in the appeal of the Revenue, Accordingly, this appeal of the Revenue also deserves to be dismissed."

(emphasis supplied by us)

10.8 On perusal of the above order, we are of the considered view, that for allowance of deduction in respect of profit / loss of its overseas branch in Singapore, USA and USA u/s 10A of the Act as claimed in this ground of appeal for A.Y. 2006-07, it has to be verified by the AO after examination of relevant facts as had been done by the Ld. CIT(A) in A.Y. 2005-06 as to whether branch offices in Singapore, USA and UK created by the assessee, operate as liaison offices for rendering on site services or such branches are engaged in rendering marketing services. Depending upon the outcome of such enquiry, the AO will take necessary action for allowance of the profits / losses of the DSL overseas unit for the claim of deduction u/s 10A of the Act, keeping in view the findings of the Co-ordinate Bench of the Tribunal in assessee's own case as reproduced and referred above. Ground no. 8 and 8.1 of the appeal are decided as per the above observation.

11. In ground nos. 9 to 9.2. of the appeal the assessee has challenged the disallowance of ESOP expenses and vide the connected additional ground of appeal dated 13.08.2014, the assessee has claimed incremental deduction of ESOP expenses in the assessment year relevant to the previous year in which the underlying ESOPs were actually exercised by the concerned employees. The assessee during the relevant previous year had claimed expenditure amounting to Rs.23,76,60,350/- in respect of stock option given to the employees under ESOP

plan/ scheme. The AO disallowed this amount on the ground that no actual expenditure has been by incurred by the assessee and the amount claimed by the assessee represented notional cost only and the underlying ESOP options have been granted by the assessee to the top-level management only and the total number of employees to whom the underlying ESOP options were granted do account only for approx. 4% of the total employees of the assessee.

11.1 The relevant findings of the AO in the draft assessment order are reproduced as under:

“ 28. The assessee had claimed ESOP expenditure of Rs. 23,76,60,350/- as an admissible item of expenditure by filing the revised return of income.

The assessee was asked to explain and justify the said ESOP expenditure. As explained by the assessee vide its letter dated 27-11-2009 & 8-12-2009, the said expenditure was incurred on account of difference between the Fair Market Value of options granted to the employees under various ESOP grants and the amount paid by the concerned employees on account of exercise money. As explained by the assessee, the said differential amount is amortized equally over the vesting period starting from the grant date and ending with the vesting date. The assessee has also cited some judicial pronouncements to substantiate the legality of the said ESOP claim.

I do not find any merit in the contentions of the assessee in respect of admissibility of impugned ESOP clam in view of the very fact that no actual expenditure has been incurred by the assessee and the amount claimed by the assessee represents notional cost only. Further, the underlying ESOP options have been granted by the assessee to the top level management only and the total number of employees to whom the underlying ESOP options were granted do account only for approx. 4% of the total employees of the assessee. Accordingly, the said ESOP claim made by the assessee in the revised return is being rejected.”

11.2 The assessee filed objections against the above findings in the draft assessment order in respect of this issue. The Ld. DRP rejected the objections filed by the assessee by concluding as under: -

“(g) next objection of the assessee is regarding disallowance by the AO of the ESOP expenses incurred by the assessee. The AO has disallowed the claim of the assessee with the observation that the expenditure claimed is only notional and no actual expenditure has been incurred by the assessee.

Before us the assessee submitted that the expenses is not notional but it has been actually incurred by the assessee. The assessee however has not established this contention with the support of any evidence. This contention of the assessee is therefore not accepted.”

11.3 After receipt of the above directions the AO passed the final assessment order and disallowed the ESOP expenses of Rs. 23,76,60,350/- which the assessee had claimed revised return of in income.

11.4 Aggrieved with the said order, the assessee is in appeal before us on the following grounds of appeal:

“9. That the assessing officer erred on facts and in law in making disallowance of ESOP expenditure of Rs. 23,76,60,350 incurred by the appellant during the relevant previous year on the ground that no actual expenditure has been by incurred by the appellant and the amount claimed by the appellant represented notional cost only.

9.1 That the assessing officer erred on facts and in law in observing that the underlying ESOP options have been granted by the appellant to the top level management only.

9.2. That the Hon'ble DRP erred on facts and in law in upholding the proposed action of the learned AO of disallowance of ESOP expenses.”

11.5 In this regard, the assessee had filed an additional ground of appeal by letter dated 13.08.2014, which is reproduced as under:

“Re: Request for admission of additional ground of appeal - Rule 11 of the Income-tax (Appellate Tribunal) Rules, 1963.

The applicant seeks to raise the following by way of an additional ground of appeal:

- 1. "Further to ground of appeal No. 9 that on the facts and circumstances of the case, the appellant should be held entitled to incremental deduction on account of ESOPs being the difference between the price on the date of exercise (as opposed to price on the date of grant) and exercise price paid by the employees.*
- 2. That on the facts and circumstances of the case, the assessing officer should be directed to allow the incremental deduction in the assessment year relevant to the previous year in which the underlying ESOPs were actually exercised by the concerned employees.*

The brief facts giving rise to the aforesaid additional grounds of appeal are as under:

The appellant is a company incorporated under the Companies Act, 1956 and is engaged in the business of rendering software development and ITES services through several STP units.

The appellant, in the return of income for the relevant assessment year, had claimed deduction of Rs.23,76,60,350 on account of ESOPs granted to the employees. The aforesaid amount was computed by spreading the difference between the price of the share on the date of grant and the exercise price to be paid by the employees over the vesting period, in line with Employees Stock Options Schemes and Employees Stock Purchase Scheme Guidelines, 1999 (the SEBI Guidelines') and as approved by the benches of the Tribunal and subsequently affirmed by the Madras High Court.

The assessing officer and DRP have denied deduction in respect of ESOPs on the ground that no actual expenditure had been incurred by the appellant and the amount claimed represented notional cost only

The Special Bench of the Tribunal in the case of Biocon Limited vs DCIT: 155 TTJ 649 has held that the amount incurred in respect of ESOP, being the difference between the market price of the share on the date of exercise by the employees and the price paid by the employees, represents actual expenditure incurred by the assessee wholly and exclusively for purposes of business, allowable deduction in terms of section 37(1) of the Act.

While the Special Bench has upheld, in principle, allowability of deduction in respect of expenditure incurred on ESOPs, the Special Bench has varied the deduction admissible to be equivalent to difference between the market price on the date of exercise (as opposed to market price on the date of grant taken by the appellant) and the price paid by the employees. As a consequence of the decision of the Special Bench, the deduction claimed by the appellant in the return of income would be varied depending upon the

movement in the market price between the date of grant and the date of exercise. Accordingly, the deduction admissible would have to be varied vis-à-vis amount claimed in the return.

Through the aforesaid additional ground of appeal No.1, the appellant claims deduction for the incremental liability in terms of the decision of the Special Bench, as aforesaid. Deduction admissible in respect of ESOP has to be allowed on spread over basis between the date of grant and the date of exercise, which may fall in different years. In that view of the matter, it would be necessary for the Hon'ble Tribunal to issue directions in respect of the amount(s) admissible in the earlier years as a consequence of following the Special Bench decision in the case of Biocon (supra) Such direction would be necessary for disposal of the present appeal and to do complete justice between the parties. Additional ground of appeal No. 2 has been raised in that behalf.

The aforesaid grounds of appeal are being raised pursuant to the decision of the Special Bench rendered subsequent to the filing of the appeal. The omission to raise the aforesaid grounds of appeal in the original memo of appeal is neither wilful nor deliberate. Further, the additional grounds of appeal raise purely legal issues not requiring any fresh investigation into facts.

In view of the discretion vested in your Honours under Rule 11 of the Income Tax (Appellate Rules) 1963, the additional grounds of appeal call for being adjudicated on merits.

The appellant trusts that the aforesaid application shall merit sympathetic consideration.”

(emphasis supplied by us)

11.6 We find that all the facts relevant for adjudication of the aforesaid additional ground are already on record. The additional ground raised by the assessee is legal in nature in as much as that in view of the decision of the Spl. Bench in the case of Biocon Ltd., the assessee wants an enabling gateway for allowance of deduction in respect of the ESOP expenditure being the amount of discount calculated as per market price of shares at the time of grant of option and market price at the time of exercise of option. However, it will involve examination of facts of such

expenditure as and when its employees exercise the final option regarding the ESOP. In this regard, the Hon'ble Delhi High Court in the case of DCM Benetton India Ltd vs CIT [2008] 173 Taxman 283 (Delhi), has held that even in the event where relevant facts are not on record, the Tribunal can always admit the additional ground and remand the matter to the file of the assessing officer to investigate and determine the facts. Hence, in view of the decision of the Hon'ble Supreme Court in the case of NTPC Limited vs CIT 229 ITR 383(SC) and in the case of DCM Benetton India Ltd vs CIT (supra), the additional grounds raised by the assessee are admitted. However, such claims will be subject to the verification of the AO.

11.7 In respect of the above ground, and the additional ground of appeal, the assessee has submitted as under:

The Appellant during the relevant previous year incurred expenditure amounting to Rs.23,76,60,350 in respect of stock option given to the employees under ESOP plan/ scheme.

AO Order

The AO disallowed the said expenditure holding that:

(i) no actual expenditure has been incurred by the Appellant and the said amount represents notional cost only;

(ii) the underlying ESOP options have been granted by the Appellant to the top-level management only and the total number of employees to whom the underlying ESOP options were granted represent an insignificant percentage of the total employees of the Appellant;

(iii) no deduction is permissible under the provisions of the Act unless the business liability has either been paid or definitely arisen during the year.

DRP Order

DRP in its order upheld the addition made by the AO holding that the issue has not attained finality and is pending before the higher forums.

Our submissions

In this regard, it is respectfully submitted that ESOP is an employee compensation scheme intended to inculcate a sense of belongingness and instill a feeling of ownership in the employees, to create partnership with the employees for a transition from being mere 'employees' to 'stakeholders'

It is submitted that, in view of the provisions of section 145 of the Act read with section 209 of the Companies Act, 1956, Appellant was mandatorily required to follow accrual basis of accounting. Accordingly, Appellant is bound to maintain books on accrual basis in accordance with various standards and guidance notes prescribed by the ICAI.

As per the "Guidance Note on Accounting for Employee Share-based Payments" issued by the ICAI, the expense incurred by an enterprise in the form of concession granted to the employee, being the difference between the fair market value of the underlying shares as on the date of grant and the exercise price which is payable by the employee at the time of exercise, has to be amortized equally over the vesting period.

Similarly, as per SEBI guidelines, which are mandatory, the amount of expenditure on ESOP (i.e., the difference between prevailing market price at the date of grant of option and price at which stock options were granted/ exercise period) is required to be treated as employee compensation in the books and charged to profit and loss account on a straight line basis over the vesting period.

The exercise of options by the employees at a future date neither has the effect of the liability on account of ESOP being converted into a contingent liability nor requires deferment of amortization of option discount since as stated above insofar as the Appellant is concerned the liability crystallizes on the date of grant itself. Thus, following mercantile system of accounting, such liability has to be allowed as deduction as 'employee compensation' expense.

Reliance in this regard is placed on the following decisions wherein it has been held that in the mercantile system of accounting, liability for amount accrued/ expenditure incurred is to be allowed as deduction, though the same is to be discharged at a future date:

- *Calcutta Company Ltd vs CIT: 37 ITR 1 (SC)*

- *Bharat Earth Movers vs CIT: 245 ITR 428 (SC)*

It is submitted that the said expenditure incurred by the Appellant, by foregoing a receivable in favour of employees on account of employee compensation, is clearly allowable as deduction under section 37 of the Act. The said expenditure, it is further submitted, cannot be disallowed merely because the payment on account of same was not made directly to employees and instead, the same was routed to employees indirectly; however, with the sole intention of benefitting employees only.

The allotment of shares to employees at discount, it is submitted, is only a mode of discharge of payment/ compensation to employees and only avoids two-way traffic.

Specific reliance in this regard is placed on the following decisions wherein expenditure on ESOP has been held to be allowable expenditure on account of being ascertained liability and not contingent/ notional liability:

*The **Special Bench of the Tribunal** in the case of **Biocon Limited vs DCIT: [2014] 144 ITD 21 (Bang Trib.) (SB)** considered the allowability of deduction in respect of discount on issue of ESOP granted to its employees. Claim of deduction of discount on grant of ESOP to the employees was disallowed by the assessing officer, inter alia, on the ground that such discount was merely a contingent liability and not crystallized liability of the assessee.*

*The Tribunal held that discount on issue of ESOP, i.e., the difference between the market price of shares on date of grant and the exercise price is deductible business expenditure since it represents consideration/ compensation for services rendered by employees. The Tribunal observed that the company incurs an obligation of issuing shares at a discounted price on a future date in lieu of the services of the employees, which is allowable as deduction under section 37(1) of the Act. **The Tribunal further held that the said discount was an ascertained liability since the employer incurs obligation to compensate the employees over the vesting period, notwithstanding the fact that the exact amount of discount is quantified only at the time of exercising the options. In coming to the said conclusion, the Tribunal placed reliance on the decisions of the Hon'ble Supreme Court in the case of Bharat Earth Movers (supra), wherein it has been held that if a business liability has arisen in an accounting year, then the deduction should be allowed in that year itself notwithstanding that such liability is incapable of exact quantification at that stage and would be discharged at a future date.***

Relevant extracts of the decision are reproduced below:

"10.2. The assessee is a limited company and hence it is obliged to maintain its accounts on mercantile basis. Under such system of accounting, an item of income becomes taxable when a right to receive it is finally acquired notwithstanding the fact that when such income is actually received. Even if such income is actually received in a later year, its taxability would not be evaded for the year in which right

to receive was finally acquired. In the same manner, an expense becomes deductible when liability to pay arises irrespective of its actual discharge. **The incurring of liability and the resultant deduction cannot be marred by mere reason of some difficulty in proper quantification of such liability at that stage. The very point of incurring the liability enables the assessee to claim deduction under mercantile system of accounting.** We have noticed the mandate of the Hon'ble Supreme Court in *Bharat Earth Movers (supra)* that if a business liability has definitely arisen in an accounting year, then the deduction should be allowed in that year itself notwithstanding the fact that such liability is incapable of proper quantification at that stage and is dischargeable at a future date. It follows that the deduction for an expense is allowable on incurring of liability and the same cannot be disturbed simply because of some difficulty in the proper quantification.

10.8. Reverting to the questions of 'when' and 'how much' of deduction for discount on options is to be granted, we hold that the liability to pay the discounted premium is incurred during the vesting period and the amount of such deduction is to be found out as per the terms of the ESOP scheme by considering the period and percentage of vesting during such period. We, therefore, agree with the conclusion drawn by the tribunal in *SSI Ltd.'s* case allowing deduction of the discounted premium during the years of vesting on a straight line basis, which coincides with our above reasoning."

The decision in the case of *Biocon Ltd (supra)* has been affirmed by the **Karnataka High Court** and the same is reported as **[2021] 430 ITR 151 (Kar)**

Similar view was taken by the **Madras High Court** in the case of ***CIT vs PVP Ventures Ltd: 211 Taxman 554 (Mad)***, wherein it has been held that the amount of difference between the market value of the shares issued under Employee Stock Option Scheme and the value at which they were allotted to the employees, which was debited to the P&L account in accordance with SEBI Guidelines, is an ascertained liability, and thus, allowable revenue expenditure under section 37(1) the Act.

To similar effect is the decision of the **Delhi High Court** in the case of ***CIT vs Lemon Tree Hotels Ltd: ITA 107/2015***, wherein the Court following the decision in the case of *PVP Ventures (supra)* held that ESOP expenses are allowable as revenue expenditure.

The decision in the case of *Lemon Tree (supra)* has been followed by the **Delhi High Court** in the case of ***PCIT vs New Delhi Television Ltd: [2017] 398 ITR 57 (Del)***.

Similarly, the **Delhi High Court** in the case of ***PVR Ltd vs CIT: [2022] 145 taxmann.com 331 (Del)*** following the decision by Karnataka High Court in the case of *Biocon (supra)*, held that deduction for the amount being difference between the price at which stock options were offered to employees of the assessee under ESOP and the prevailing market price of the stock on the date of grant of such options, shall be allowable.

It has similarly been held in the following cases:

- *ACIT vs People Strong HR Services (P.) Ltd: [2022] 193 ITD 105 (Del Trib.)*
- *Jubilant Foodworks Ltd vs DCIT: [2025] 171 taxmann.com 727 (Del Trib.)*
- *Bharti Airtel Ltd vs JCIT: ITA No.1912/Del/2016 (Del Trib.)*
- *Mahindra & Mahindra Ltd vs DCIT: [2020] 117 taxmann.com 518 (Del Trib.)*
- *Ranbaxy Laboratories Ltd vs ACIT: [2016] 68 taxmann.com 322 (Del Trib.)*
- *Religare Commodities Ltd vs ACIT: ITA No. 2283/Del/2013 (Del Trib.)*
- *Bharti Airtel Ltd. vs. DCIT (LTU):161 TTJ 283 (Del. Trib.)*
- *SSI Ltd vs DCIT: 85 TTJ 1049 (Chen. Trib.)*
- *Spray Engineering Devices: (2012) 53 SOT 70 (Chd. Trib.)*
- *Dr. Reddy's Laboratories Ltd vs ACIT: ITA No. 294/Hyd/2014 (Hyd Trib.)*
- *Mahindra & Mahindra Ltd. vs ACIT: (2013) ITA No.586/Mum/2013 (Mum. Trib)*

In view of the aforesaid, it is submitted that the issue on hand being squarely covered in favour of the Appellant by decisions of the jurisdictional High Court, Madras High Court, Special Bench of the Tribunal as well as various benches of the Tribunal, deserves to be decided in favour of the Appellant.

Re: Additional claim of deduction

The Appellant claimed an additional amount of deduction before your Honour, being the amount of discount calculated as per market price of shares at the time of grant of option and market price at the time of exercise of option. The said claim was made pursuant to decision passed by the Special Bench in the case of Biocon Ltd vs DCIT: [2013] 144 ITD 21 (Bang Trib.) (SB).

The aforesaid claim of the Appellant is squarely covered by the decision of the Special Bench of the Tribunal in the case of Biocon (supra), wherein it was held as under:

“III. SUBSEQUENT ADJUSTMENT TO DISCOUNT

11.1.1 Having answered the first major issue in affirmative that the discount on options under ESOP is an ascertained liability and the second major issue that the discount is deductible over the vesting period on straight line basis unless the vesting is not uniform, then arises the present issue as to whether any subsequent adjustment is warranted at the time of exercise of options, to the deductions earlier allowed for the amount of discount. It is noticed that the assessment years 2003-2004 to 2007-2008 are under consideration and during these years ESOP 2000 has come to an end and the ESOP 2004 has started. Further, the extant issue is a vital part of the overall question of the deductibility or otherwise of the amount of discount under ESOP.

11.1.2 We have noticed above that the company incurs a definite liability during the

vesting period, but its proper quantification is not possible at that stage as the actual amount of employees cost to the company, can be finally determined at the time of the exercise of option or when the options remain unvested or lapse at the end of the exercise period. It is at this later stage that the provisional amount of discount on ESOP, initially quantified on the basis of market price at the time of grant of options, needs to be suitably adjusted with the actual amount of discount.

.....

11.1.6 The amount of discount at the stage of granting of options w.r.t. the market price of shares at the time of grant of options is always a tentative employees cost because of the impossibility in correctly visualizing the likely market price of shares at the time of exercise of option by the employees, which, in turn, would reflect the correct employees cost. Since the definite liability is incurred during the vesting period, it has to be quantified on some logical basis. It is this market price at the time of the grant of options which is considered for working out the amount of discount during the vesting period. But, since actual amount of employees cost can be precisely determined only at the time of the exercise of option by the employees, the provisional amount of discount availed as deduction during the vesting period needs to be adjusted in the light of the actual discount on the basis of the market price of the shares at the time of exercise of options. It can be done by making suitable northwards or southwards adjustment at the time of exercise of option. This can be explained with the following example with the assumption of vesting period of four years and the benefit vesting at 25% each at the end of 1st to 4th years:—

	At the time of granting option	At the time of exercise of option		
		Situation I	Situation II	Situation III
Market value per share	110	110	130	90
Option price	10	10	10	10
Employees compensation or Discount	100	100	120	80

11.1.7 From the above table it can be noticed that the market price of the shares at the time of grant of option was Rs. 110 against the option price of Rs. 10, which resulted in discount at Rs. 100. With the vesting period of four years with the equal vesting, the company can rightly claim deduction at the rate of Rs. 25 each at the end of first, second, third and fourth year of vesting. But this total deduction for discount of Rs. 100 over the vesting period needs to be adjusted at the time of exercise of option by the employee when the shares are issued. In Situation I, the market price of shares at the time of exercise of option is at Rs. 110, which is similar to the market price at the time of grant of option. As the total amount of discount of Rs. 100 over the vesting period is actually quantified at Rs. 100, no further adjustment to the discount is required at the time of exercise of option. In Situation II, the market price of the share at the time of exercise of option has gone up to Rs. 130. The amount of real compensation to employee is Rs. 120 as against the tentative compensation of Rs. 100 per share which was accounted for and allowed as deduction during the vesting period. As the actual quantification of the compensation has turned out to be Rs. 120, the company is entitled to a further deduction of Rs. 20 at the time of exercise of option. In Situation III, the market price of the share at the time of exercise of option has come down to Rs. 90. The amount of real compensation to employees is Rs. 80 as against the tentative compensation of Rs. 100, which was allowed as deduction during the vesting period. As the actual quantification of the compensation has turned out to be Rs. 80, the company is liable to reverse the deduction of Rs. 20 at the time of exercise of option.

.....

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'."

As stated supra, the aforesaid decision in the case of Biocon has been affirmed by the Karnataka High Court.

In the following decisions as well, relying on the decision in the case of Biocon (supra), benches of the Tribunal have allowed deduction in respect of difference in market price at the time of grant and market price at the time of exercise of option:

- *Mahindra & Mahindra Ltd vs DCIT: [2020] 117 taxmann.com 518 (Mum Trib.)*
- *Bharti Airtel Ltd vs JCIT: [2019] ITA No.1912/Del/2016 (Del Trib.)*
- *Axis Bank Ltd vs ACIT: ITA Nos.142 & 143/Ahd/2024 (Ahd Trib.)*

In view of the aforesaid, it is respectfully submitted that the additional claim of the Appellant shall be allowed.”

(emphasis supplied by us)

11.8 On the other hand, the Spl. Counsel relied upon the order of the authorities below.

11.9 We have heard both the parties and perused the material available on record. The case of the Assessing Officer is that no actual expenditure has been incurred by the assessee and the amount claimed by the assessee represents notional cost only. However, the issue regarding the allowability of such liability in respect of ESOP expenses has been decided by the Special Bench of the Tribunal in the case of *Biocon Ltd. v. DCIT* (supra). The Special Bench, relying upon the decision of the Hon'ble Supreme Court in the case of *Bharat Earth Movers Ltd.*, held that in the mercantile system of accounting which is mandatory as per the provision of section 145 of the Act in the case of company the expenses become deductible when liability to pay arises irrespective of its actual discharge. It further held that the incurring of liability and the resultant deduction cannot be marred by mere reason

of some difficulty in proper quantification of such liability at that stage. The Tribunal further held that the very point of incurring the liability enables the assessee to claim deduction under mercantile system of accounting. The Tribunal further noted that they had noticed the mandate of the Hon'ble Supreme Court in Bharat Earth Movers (supra) which held that if a business liability has definitely arisen in an accounting year, then the deduction should be allowed in that year itself notwithstanding the fact that such liability is incapable of proper quantification at that stage and is dischargeable at a future date. The Tribunal in view of the above observation held that it follows that the deduction for an expense is allowable on incurring of liability and the same cannot be disturbed simply because of some difficulty in the proper quantification. Similarly, the Delhi High Court in the case of PVR Ltd vs CIT: [2022] 145 taxmann.com 331 (Del) following the decision by Karnataka High Court in the case of Biocon (supra), held that deduction for the amount being difference between the price at which stock options were offered to employees of the assessee under ESOP and the prevailing market price of the stock on the date of grant of such options, shall be allowable.

11.10 In view of the aforesaid decision, we direct the AO to allow the expenses of Rs. 23,76,60,350/- as claimed by the assessee after due verification. Ground no. 9 to 9.2 is allowed as per the above observation.

11.11 As noted above, this claim for incremental deduction on account on adjustment to the income 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 was made by the assessee, pursuant to the order passed by the Special bench of the Tribunal in the case of Biocon Ltd. vs. DCIT [2013] 144 ITD 21 (Bang Trib.) (SB).

In this regard, the relevant part of the said order is reproduced once again.

*“ 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'*

11.12 We relying upon the above order of the Tribunal direct the AO to allow, an adjustment to the income 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. In this regard, the assessee is directed to furnish the necessary details of the such additional expenditure and the AO upon verification will allow the same. Ground

nos. 9 to 9.2 are allowed and additional ground are allowed as per the above observation.

12. In ground no. 10 to 10.3 of the appeal, the assessee has challenged the disallowance of Software License Fee holding the same to be capital expenditure instead allowing the depreciation thereon @60%.

12.1 The relevant finding of the AO in the assessment order is reproduced as under:

“29. Expenses incurred for Software License Fee of Rs.31.69 crores:

Regarding expenses incurred by the assessee company for Software License Fee of Rs.31.69 crores, the assessee was asked to furnish the details of the said expenditure incurred on account of Software License Fee.

On verification of the details, it was found that out of the said total amount of Rs. 31.69 crores, as explained by the assessee, an amount of Rs. 6.33 crores was in the nature of software license fee paid for the software which has been used for executing various revenue generating projects and the remaining amount of Rs. 25.36 crores was paid for the software used in day to day operations of the assessee having no correlation with any specific project. The assessee was further asked to explain as to why the said amount of Rs. 25.36 crores should not be disallowed and the same should not be allowed as Capital Expenditure by capitalizing the same under the head "Computers",

In response to the said query, it was further explained by the assessee that the said amount of Rs. 25.36 crores represents an expenditure of revenue nature only having regard to the fact that no asset was acquired by the assessee and it was only a limited right to use the underlying software only which the assessee had acquired. As such, no benefit of an enduring nature was acquired by the assessee. As an alternate claim, the assessee has contended that if an opinion that it represents a capital expenditure is held, depreciation allowed to the assessee company

I have carefully considered all the explanation and documents filed by the assessee in this regard. I am not satisfied with the contention of the assessee that no benefit of enduring nature has been obtained by the assessee company as a result of the said expenditure to the tune of Rs. 25.36 crores. The said fact of enduring nature is clearly evident by the very fact that as per software licensing agreement between the Assessee Company and Microsoft (to which an amount of Rs. 14.06 crores has been

paid out of total remaining amount of Rs.25.36 crores), the agreement has tenure of more than one year (i.e. 3 years) and as such, the fact of enduring nature benefit is clearly established.

Accordingly, the said amount of software license fee of Rs. 25.36 Crores is being disallowed as revenue expense and the same is being treated as being capitalized under the head "Computers". As a result, depreciation @ 60% is allowed instead of allowing deduction @ 100% as revenue expense."

12.2 The assessee filed objections against the above findings in the draft assessment order in respect of this issue. The Ld. DRP rejected the objection filed by the assessee by concluding as under: -

"K. The next objection of the assessee is regarding disallowance of the Software License Fee by the AO by assuming the same to be an expenditure of a capital nature and allowing the depreciation thereon @ 60% by the AO."

Assessee's submissions in this regard before us were as follows:

"Such software license fee, it is respectfully submitted, was paid for acquiring limited right to use software licenses for the purpose of business of the assessee.

It is respectfully submitted that the aforesaid expenditure pertaining to license fee paid is in respect of various "off the shelf" software's purchased by the assessee company which was for smooth functioning of the software installed and for improving the functioning of the organization. The expenditure incurred is clearly in the nature of revenue expenditure and allowable as such under the provisions of the Act."

12.3 Thereafter, the AO passed the final assessment order and made an addition of Rs. 25.36 Crores claimed by the assessee on account of software licenses. The AO further observed that since the depreciation on the software license fee of Rs. 25.36 Crores was allowable @60% by treating it as "Computers" which comes out to be Rs. 15.22 Crores, the AO added net amount of Rs. 10.14 Crores to the total income of the assessee company.

12.4 Aggrieved with the said order, the assessee is in appeal before us on the following grounds of appeal:

“10. That the assessing officer erred on facts and in law in arbitrarily disallowing the expenditure on payment of software license fee of Rs. 101,439,827 holding the same as an addition to Computers and allowing depreciation thereon @ 60%

10.1. That the assessing officer erred on facts and in law in holding that benefit of an enduring nature was obtained by the appellant as a result of the software license fee paid by the appellant not appreciating that such software license fee did not result in creation of any capital asset and was not in the capital field.

10.2. That the Hon'ble DRP erred on facts and in law in upholding the proposed action of the learned AO of treating the software license fee as a capital expenditure.

10.3. Without prejudice that the assessing officer erred on facts and in law in not correspondingly increasing the deduction admissible under section 10A of the Act by taking into account the profits and gains from business or profession being recomputed by the assessing officer after considering the disallowance of software license expenses of Rs. 10,14,39,827.

12.5 In this regard, the assessee filed a written submission, which is reproduced as under:

The assessing officer during the relevant previous year disallowed expenditure amounting to Rs.25.36 crores being software license fee holding the same to be capital expenditure.

Such software license fee was paid for acquiring limited right to use software licenses for the purpose of business of the appellant. The aforesaid expenditure pertaining to license fee paid is in respect of various “off the shelf” software purchased by the appellant, which was for smooth functioning of the software installed and for improving the functioning of the organization. The expenditure incurred is clearly in the nature of revenue expenditure and allowable as such under the provisions of the

Act.

The aforesaid expenditure on computer software, it is submitted, did not result in an enduring benefit in the capital field and, therefore, the same is not in the nature of capital expenditure.

*The Hon'ble Delhi High Court in the case of **CIT vs K & Co: 181 CTR 378** held that the order of the Tribunal holding that expenditure incurred by assessee on maintenance of computer and their upgradation including development of software was in the nature of revenue expenditure and did not give rise to any substantial question of law.*

*Reliance is also placed in the case of **CIT vs GE Capital Services Ltd** reported in **(2008) 300 ITR 420 (Del)** wherein purchase of MS Office software was held to be of revenue nature since it was not custom built and would have required alterations.*

*The above expenses are to be regarded as incurred on revenue field as per the test laid down by the Special Bench of Tribunal in the case of **Amway India Enterprises: 111 ITD 112 (Del) (SB)** – affirmed by Delhi High Court in the case of **CIT vs Asahi India Safety Glass Ltd: 346 ITR 329 (Del)**, in as much as (i) such computer software does not have utility for long duration and hence do not result in enduring benefit and (ii) such software does not constitute profit earning apparatus and merely enable the appellant to efficiently conduct its business.*

*The Delhi High Court in the case of **Oracle India Pvt Ltd vs CIT: 221 Taxman 249 (Del HC)**, following the decision in the case of Asahi India (supra), too held that expense incurred on software licenses is revenue expenditure.*

*To the same effect is the decision of Hon'ble Madras High Court in the case of **CIT vs Southern Roadways Ltd: 304 ITR 84 (Mad)**. The decision was also followed by the Hon'ble High Court in the case of **CIT vs Karur Vyasa Bank Ltd (229 Taxman 396)**.*

To the same effect are the following decisions:

- *CIT vs Varinder Agro Chemicals Ltd.: 309 ITR 272 (P&H)*

- *CIT vs Kotak Securities Ltd. (No. 1): 346 ITR 349 (Bom.)*
- *CIT vs Raychem RPG Ltd.: 346 ITR 138 (Bom.)*
- *ITO vs Spice Communications Ltd.: 35 SOT 78 (Del. ITAT)*
- *Gujarat Guardian Ltd vs DCIT : [2014] 35 ITR(T) 217 (Delhi-Trib)*
- *DCIT vs Eicher Motors Ltd : [2015] 53 taxmann.com 317 (Delhi-Trib)*

Since the right to use the underlying software is acquired by the assessee company for the purpose of carrying out its business of developing the customized software for its end customers, no revenue per-se was generated by the assessee company from any of such licensed software. It is further submitted that even otherwise, the assessee company, having the limited right to use only, is not entitled to generate any revenue from the underlying licensed software by further sub-leasing the underlying software to any third party.

The action of the assessing officer in treating the aforesaid license as an intangible asset liable for depreciation @ 60% is, therefore, in our respectful submission, not based on correct appreciation of facts and law.

In view of the aforesaid, the above software expenses of Rs.25.36 crores are liable to be allowed as revenue deduction in the relevant previous year, instead of depreciation @ 60% allowed by the assessing officer.”

12.6 On the other hand, the Ld. Sr. Counsel relied upon the order of the authorities below.

12.7 We have heard both the parties and perused the material available on record. The assessee submits that the software license fees was paid for acquiring limited right to use software licenses for the purpose of business of the assessee and the aforesaid expenditure pertaining to license fee paid was in respect of various “off the shelf” software purchased by the assessee which was for smooth functioning of the software installed and for improving the functioning of the organization and was

clearly in the nature of revenue expenditure and allowable as such under the provisions of the Act. The Spl. Counsel further submitted that its case was covered by the order of the Hon'ble Delhi High Court in the case of CIT vs. Asahi India Safety Glass Ltd. 346 ITR 329 (Del.), in as much as (i) such computer software does not have utility for long duration and hence do not result in enduring benefit and (ii) such software does not constitute profit earning apparatus and merely enable the assessee to efficiently conduct its business.

12.8 However, on the other hand, the AO has given a finding that a part of above purchase was of enduring nature which was clearly evident by the fact that as per the software license agreement between the assessee company and Microsoft to which an amount of Rs. 14.60 crores were paid out of the total remaining amount of Rs. 25.36 crores the agreement had tenure more than 1 year (i.e. 3 year) and as such the fact of enduring nature of benefit was clearly established. This finding of the AO has not been contested decided by the assessee in its written submission. Therefore, this fact requires factual verification vis a vis a claim made by the assessee that the software purchase was in respect of various 'of the self 'software purchase by the assessee for in the smooth functioning of the software installed and for improving the functioning of the as against the above finding of the AO. Therefore, this issue is set aside of the file of the AO to decide the issue *denovo* as per law, after giving reasonable opportunity of being heard to the assessee.

12.9 Further assessee will also be at liberty to furnish any details / evidence in support of his claim.

13. In ground no. 11 of the appeal, and the additional ground of appeal filed on 31.05.2016, the assessee submits that the AO did not allow credit of taxes paid in USA in respect of STPI units. The Ld. Counsel also filed an additional ground vide letter dated 31.05.2016 and submitted that AO ought to have allowed Foreign Tax Credit of Rs.17,42,40,152 (including enhanced claim to the extent of Rs.15,20,58,506) in pursuance to law clarified by the Hon'ble Karnataka High Court in the case of Wipro Ltd vs DCIT: [2015] 382 ITR 179 (Kar). The assessee also filed additional evidences in terms of Rule 29 of the IT(AT) Rules, 1962 on 09.06.2016.

13.1 This claim was raised for the first time by the assessee by way of an objection before the DRP to the effect that foreign tax credit should be allowed to the assessee as permissible under Section 90 of the Income Tax Act, 1961 as an alternate claim. The directions of the DRP in this regard are reproduced as under:

“(i) The next objection of the assessee is that the AO has not entertained the assessee's alternate claim of allowing credit for foreign taxes paid for the profits of the foreign undertakings on which deduction u/s 10A has been denied.

This claim of the assessee is justified. The AO is directed to allow the claim of the assessee as per law after due verification.”

13.2 The relevant discussion by the AO in the final assessment order is reproduced as under:

40 "The assessee had raised an objection before the DRP to the effect that foreign tax credit should be allowed to the assessee as permissible under Section 90 of the Income Tax Act, 1961 as an alternate claim. In response to the said objection as raised by the assessee, the DRP has observed as under:-

Para A (1) (i) of the DRP Order

"The next objection of the assessee is that the AO has not entertained the assessee's alternate claim of allowing credit for foreign taxes paid for the profits of the foreign undertakings on which deduction u/s 10 has been denied.

The claim of the assessee is justified. The AO is directed to allow the claim of the assessee as per law after due verification."

41. Since the copy of the DRP dated 30.09.2010 was also served on the assessee company, the assessee filed a letter dated October 25, 2010, in my office in support of its Foreign Tax Credit claim wherein the assessee company has submitted as under:-

A. Details of Foreign taxes paid by the assessee company

<i>S. No.</i>	<i>Name of Foreign Country</i>	<i>Name of Foreign customer who had deducted and deposited WHT on of the behalf assessee company</i>	<i>Name of Payment</i>	<i>Amount of FTC</i>
<i>1.</i>	<i>United states of America</i>	<i>WHT was initially deducted by HCL America Inc. and then tax return as filed by the assessee comapny</i>	<i>Earlier it was in the nature of WHT however it subsequently got converted into self assessment taxes by the reason of filing of US tax return by the company</i>	<i>1,68,74,708/-</i>

2.	<i>Australia</i>	<i>HCL Australia</i>	<i>WHT</i>	<i>29,01,715/-</i>
3.	<i>New Zealand</i>	<i>HCL New Zealand</i>	<i>WHT</i>	<i>24,05,223/-</i>
<i>Total</i>				<i>2,21,81,646/-</i>

The assessee has also furnished the following documents in support of its claim of foreign tax credit:-

a) Copies of the relevant Withholding Tax Credit ("WHT") certificates issued by the foreign entities (i.e. HCL Australia Pte Limited and HCL New Zealand Limited) which had deducted and deposited the WHT on the behalf of the assessee from the doubly taxed income in case of Australia and New Zealand;

b) Copies of the relevant foreign tax returns filed by the assessee in case of USA;

c) Copies of the relevant tax treaties between India and USA/India and Australia/India and New Zealand in support of its FTC claim.

b) Statutory Provisions in support of Foreign Tax Credit Claim of the assessee company

a) Relevant extract from Section 90 of the Income Tax Act, 1961

Section 90 (Agreement with foreign countries or specified territories)

(1) The Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India,

(a) for the granting of relief in respect of

(i) income on which have been paid both income-tax under this Act and income-tax in that country or specified territory, as the case may be, or

(2) Where the Central Government has entered into an agreement with the Government of any country outside India or specified territory outside India, as the case may be, under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee."

b) Relevant extract from the Double Taxation Avoidance Agreement between the Government of India and United States of America dated 20-12-1990

"Article 25-Relief from double taxation -

2. (a) *Where a resident of India derives income which, in accordance with the provisions of this Convention, may be taxed in the United States, India shall allow as a deduction from the tax on the income of that resident an amount equal to the income-tax paid in the United States, whether directly or by deduction. Such deduction shall not, however, exceed that part of the income-tax (as computed before the deduction is given) which is attributable to the income which may be taxed in the United States.*

.....”

c. Relevant extract from the Double Taxation Avoidance Agreement between the Government of India and Australia dated 22-01-1992

ARTICLE XXIV - Methods of elimination of double taxation

.....

in the case of India, double taxation shall be avoided as follows

(1) the amount of Australian tax paid under the laws of Australia and in accordance with the provisions of this Agreement, whether directly or by deduction, by a resident of India in respect of income from sources within Australia which has been subjected to tax both in India and Australia shall be allowed as a credit against the Indian tax payable in respect of such income but in an amount not exceeding that proportion of Indian tax which such income bears to the entire income chargeable to Indian tax; and

(b) for the purposes of the credit referred to in sub-paragraph (a) above, where the resident of India is a company by which surtax is payable, the credit to be allowed against Indian tax shall be allowed in the first instance against the income-tax payable by the company in India and, as to the balance, if any, against the surtax payable by it in India.

d. Relevant extract from the Double Taxation Avoidance Agreement between the Government of India and New Zealand dated 27-03-1987 as further amended on 21-04-1988 and on 12-01-2000

"ARTICLE 23-Elimination of double taxation

2. (a) *Subject to the provisions of the law of India relating to the allowance as a credit against Indian tax of tax paid in any country other than India (which shall not affect the general principle hereof), New Zealand tax paid under the law of New Zealand and consistently with this Convention, whether directly or by deduction, in respect of income derived by a resident of India from sources in New Zealand (excluding, in the case of a dividend, tax paid in respect of the profits out of which the dividend is paid), shall be allowed as a credit against Indian tax payable in respect of that income.*

(b) For the purposes of this article, income of a resident of India which in accordance with the provisions of this Convention may be taxed in New Zealand shall be deemed to arise from sources in New Zealand"

Explanation regarding the nature of Foreign Taxes and the treatment thereof in the books of the assessee company

As explained by the assessee company, the underlying foreign taxes on account of which the assessee company is claiming the foreign tax credit are in the nature of Withholding Taxes ("WHT") which the foreign customers of the assessee company had deducted and deposited on the behalf of the assessee company in their respective foreign jurisdictions (i.e. in USA, Australia and New Zealand). As further explained by the assessee company, the said WHT was deducted from the payments which the assessee company had received against the invoices which it had raised during the financial year under consideration on account of onsite services which the employees of the assessee company had performed outside India. It has also been confirmed by the assessee company that the underlying onsite revenues (on which the assessee company is claiming the foreign tax credit) are included at the gross amounts (including the amount withheld by the foreign customers outside India) in the total revenues as shown in the Undertaking wise P&L Account for the financial year under consideration.

However, as explained by the assessee company, in case of USA, since the assessee company had filed its tax return in the USA to offer for tax (on net basis) the entire amount of onsite revenues for which onsite operations were performed by the employees of the assessee company in the USA, the foreign tax credit which the assessee company is claiming is based on the taxes payable as per the respective returns of income filed by the assessee company in the USA instead of being based on the WHT which was originally deducted by the USA based foreign customer(s).

42 *"After analyzing all the documents, explanations and the basis of calculating the amount of Foreign Tax Credit as furnished by the assessee company. I do hereby conclude that out of total foreign tax credit as claimed by the assessee company. it is only an amount of Rs. 53,06,938/- (i.e. Rs. 29.01,715/- in case of Australia + Rs 24.05 223/- in case of New Zealand) which is allowable to the company in view of the fact that it is clearly evident from WHI Certificates filed by the assessee company in support of Foreign Tax Credit claim in case of Australia and New Zealand that the said FTC claim of Rs. 53,06,938/- pertains to the taxable undertakings of the assessee company only. However, the FTC Claim of Rs. 1,68,74,708/- which the assessee company has claimed in case of USA on account of taxes paid in USA is not accepted because the assessee could not furnish the necessary documents to substantiate the fact that*

exactly to which undertakings of the assessee company, the said amount of Rs. 1.68.74.708/- pertains.

Accordingly, the foreign tax credit of Rs. 53,06,938/- is allowed to the assessee company as pre-paid taxes on the basis of the direction of the order of the DRP dated 30.09.2010. "

(emphasis supplied by us)

13.3 Aggrieved with the said final assessment order, the assessee filed ground no. 11 and the additional ground of appeal and the additional evidences in terms of Rule 29 of the IT(AT) Rules, 1963 which are reproduced as under:

"Re : Additional Ground:

Re: Request for admission of additional ground of appeal Rule 11 of the Income-tax (Appellate Tribunal) Rules, 1963.

The appellant has by way of Ground of Appeal No.11 raised the following ground regarding the claim of Foreign Tax Credit ('FTC'):

11 "Without prejudice that the assessing officer erred on facts and in law in not allowing the credit of foreign taxes paid in the United States of America in respect of doubly taxed income of the taxable STPI Licenses/ Units despite the directions of the Hon'ble DRP in this regard in the order passed under Section 144C(8) of the Act."

The appellant craves leave to raise additional ground of appeal as under:

11.1 That on the facts and circumstances of the case and in law, the assessing officer ought to have allowed the FTC of Rs. 17,42,40,152 (including enhanced claim to the extent of Rs. 15,20,58,506 in pursuance to law clarified by the Hon'ble Karnataka High Court in the case of Wipro Ltd vs DCIT: (2015) 62 Taxmann.com 26), instead of restricting it to Rs 53,06,938 only.

The brief facts giving rise to the aforesaid additional ground of appeal are as under

The appellant is a company incorporated under the Companies Act, 1956 and is engaged in the business of rendering software development and ITES services through several STP units.

The appellant, in the return of income filed for the relevant assessment year, claimed FTC amounting to Rs 2.21,81,646 comprising FTC of Rs. 1.68.74.708 as taxes paid by US PE of the appellant and Rs.53,06,938 on WHT deducted by foreign entities. In the assessment order passed pursuant to directions issued by the Dispute Resolution Panel ('DRP'), the assessing officer allowed FTC of Rs.53,06,938 which pertained to WHT deducted by HCL Australia and HCL New Zealand.

Breakup of the aforesaid FTC claim of Rs.2.21.81,646 made by the assessee in its return of income is as under:

S. No.	Particulars	FTC claimed during assessment proceedings	Section under which FTC claimable	Remarks
1	Federal taxes paid by US PE	1,68,74,708	90	FTC claim was restricted to the tax payable in India on such billing
2	State taxes paid by US PE	0	91	FTC was not claimed on account of US State Taxes.
3	WHT deducted by HCL Australia	29,01,715	90	FTC was claimed only in respect of WHT deducted on billing made by taxable units of the appellant.
4	WHT deducted by HCL NZ	24,05,223	90	FTC was claimed only in respect of WHT deducted on billing made by taxable units of the appellant.

Recently, the Hon'ble Karnataka High Court in the case of Wipro Ltd vs DCIT: [2015] 62 Taxman.com 26, while interpreting the provisions of section 90A(1)(a)(ii) of the Income-tax Act, 1961 ('the Act') providing for relief from double taxation where income of the assessee is chargeable under the Act as well as in the corresponding law in force in the foreign country. held that "Income under section 10A is chargeable to tax under section 4 and is includible in the total income under section 5, but no tax is charged on such income because of the exemption given under section 10A

The Hon'ble High Court held that having regard to the language of Article 25 of India-USAA DTAA, there is no requirement of capping the amount of FTC claimable in India to the taxes actually paid in India on doubly taxed income and the FTC credit in India can be claimed for the full amount of foreign taxes paid in USA. The only requirement of claiming full FTC in India is that the underlying income per-se should not be an exempt income.

The Hon'ble Court also held that it is settled position of law that income of a STPI/SEZ unit, being covered u/s 10A/10AA of the Act, is very much chargeable to tax but it is subsequently excluded from total income as a deduction only (rather than as an exemption) by the reason of special economic incentive stipulated by these sections.

The Hon'ble Court accordingly concluded that merely because the exemption has been granted in respect of the taxability of the said source of income, it cannot be postulated

that the assessee is not liable to tax and therefore, assessee would be entitled to take credit of income tax paid in a country outside India in relation to income eligible for deduction under section 10A. Copy of the said decision is enclosed as Annexure I

Considering the law as clarified by the Hon'ble Karnataka High Court (supra), the appellant by way of present application seeks to enhance the claim of foreign tax credit from Rs.2,21,81,646 claimed earlier to Rs 17,42,40,152 as follows:

S. No.	Particulars	FTC claimed during assessment proceedings	Claimable as per Wipro	FTC to be claimed by way of additional ground based on Wipro	Reason for additional FTC
1	Federal taxes paid by US PE	1,68,74,708	14,64,98,052	12,96,23,344	Earlier the appellant was claiming FTC only in respect of billing done by taxable units of the appellant. Also, the FTC claim was restricted to the tax payable in India on such billing. Relying on the Karnataka High Court decision, the appellant is now claiming FTC based on the entire

					amount of taxes paid by our US PE.
2	State taxes paid by US PE	0	1,00,52,965	1,00,52,965	Earlier, the appellant was not claiming FTC on State taxes paid by US PE. In view of the Karnataka High Court decision, FTC is claimed on these taxes as well.
3	WHT deducted by HCL Australia	29,01,715	29,01,715	0	NA
4	WHT deducted by HCL NZ	24,05,223	1,47,87,420	1,23,82,197	Earlier, the appellant was claiming FTC only in respect of WHT deducted on billing made by taxable units of HCLT. Following the Karnataka High Court decision, FTC is now claimed on the basis of actual WHT deducted by HCL NZ on all units of HCLT.
		2,21,81,646	17,42,40,152	15,20,58,506	

The relevant documents and evidences in support of the aforesaid claim of foreign tax credit are enclosed as Annexure II. Relevant extract of Double Taxation Avoidance Agreement (DTAA) with the aforesaid countries are also enclosed as Annexure III.

The aforesaid grounds of appeal are being raised pursuant to the decision of the Hon'ble Karnataka High Court rendered subsequent to the filing of the appeal. The omission to raise the aforesaid grounds of appeal in the original memo of appeal is neither wilful nor deliberate. Further, the additional grounds of appeal raise purely legal issues not requiring any fresh investigation into facts.

In view of the discretion vested in your Honours under Rule 11 of the Income Tax (Appellate Rules) 1963, the additional grounds of appeal call for being adjudicated on merits.

The appellant trusts that the aforesaid application shall merit sympathetic consideration.

An opportunity of being heard is prayed for.”

Re: Request for additional evidences

“Re: Request for admission of additional evidence in terms of Rule 29 of the Income-tax (Appellate Tribunal) Rules, 1963.

The applicant craves leave to place the following by way of additional evidence:

"Documents and evidences being details of federal taxes and state taxes paid in USA and details of tax withholding made by HCL (New Zealand) Ltd in support of the claim of foreign tax credit. (placed at pages 56-430 herein)"

In this regard, it is submitted as under.

The applicant is a company incorporated under the Companies Act, 1956 and is engaged in the business of rendering software development and ITES services through several STP units

The applicant, in the return of income filed for the relevant assessment year, claimed FTC amounting to Rs.2.21,81,646 comprising FTC of Rs. 1,68,74,708 as taxes paid by US PE of the applicant and Rs.53,06,938 on WHT deducted by foreign entities. In the assessment order passed pursuant to directions issued by the Dispute Resolution Panel ('DRP'), the assessing officer allowed FTC of Rs. 53,06,938 which pertained to WHT deducted by HCL Australia and HCL New Zealand

Breakup of the aforesaid FTC claim of Rs 2.21.81.646 made by the applicant in its return of income is as under

<i>S. No</i>	<i>Particulars</i>	<i>FTC claimed during assessment proceedings</i>	<i>Section under which FTC claimable</i>	<i>Remarks</i>
<i>1.</i>	<i>Federal taxes paid by US PE</i>	<i>1,68,74,708</i>	<i>90</i>	<i>FTC claim was restricted to the tax payable in India on such billing</i>
<i>2</i>	<i>State taxes paid by US PE</i>	<i>0</i>	<i>91</i>	<i>FTC was not claimed on account of US State Taxes</i>

3	<i>WHT deducted by HCL Australia</i>	29,01,715	90	<i>FTC was claimed only in respect of WHT deducted on billing made by taxable units of the appellant</i>
4	<i>WHT deducted by HCL NZ</i>	24,05,223	90	<i>FTC was claimed only in respect of WHT deducted on billing made by taxable units of the appellant</i>
		2,21,81,646		

Recently, the Hon'ble Karnataka High Court in the case of Wipro Ltd vs DCIT: [2015] 62 Taxman.com 26, while interpreting the provisions of section 90A(1)(a)(ii) of the Income-tax Act, 1961 (the Act") providing for relief from double taxation where income of the assessee is chargeable under the Act as well as in the corresponding law in force in the foreign country. held that "Income under section 10A is chargeable to tax under section 4 and is includible in the total income under section 5, but no tax is charged on such income because of the exemption given under section 10A

The Hon'ble High Court held that having regard to the language of Article 25 of India-USAA DTAA, there is no requirement of capping the amount of FTC claimable in India to the taxes actually paid in India on doubly taxed income and the FTC credit in India can be claimed for the full amount of foreign taxes paid in USA. The only requirement of claiming full FTC in India is that the underlying income per-se should not be an exempt income

The Hon'ble Court also held that it is settled position of law that income of a STPI/ SEZ unit being covered u/s 10A/10AA of the Act, is very much chargeable to tax but it is subsequently excluded from total income as a deduction only (rather than as an exemption) by the reason of special economic incentive stipulated by these sections

The Hon'ble Court accordingly held that merely because the exemption has been granted in respect of the taxability of the said source of income, it cannot be postulated that the assessee is not liable to tax and therefore, assessee would be entitled to take credit of income tax paid in a country outside India in relation to income eligible for deduction under section 10A.

Considering the law as clarified by the Hon'ble Karnataka High Court (supra), the applicant has separately moved an application under rule 11 of the Income-tax (Appellate Tribunal) Rules of even date raising additional ground seeking to claim foreign tax credit (FTC) amounting to Rs 17,42,40,152 instead of the original claim of Rs.2.21,81,646 made in the return of income, as follows:

S. No.	Particulars	FTC claimed during assessment proceedings	Claimable as per Wipro	FTC to be claimed by way of additional ground based on Wipro	Reason for additional FTC
1	Federal taxes paid by US PE	1,68,74,708	14,64,98,052	12,96,23,344	Earlier the appellant was claiming FTC only in respect of billing done by taxable units of the appellant. Also, the FTC claim was restricted to the tax payable in India on such billing. Relying on the Karnataka High Court decision, the appellant is now claiming FTC based on the entire amount of taxes paid by our US PE.
2	State taxes paid by US PE	0	1,00,52,965	1,00,52,965	Earlier, the appellant was not claiming FTC on State taxes paid by US PE. In view of the Karnataka High Court decision, FTC is claimed on these taxes as well.
3	WHT deducted by HCL Australia	29,01,715	29,01,715	0	NA

4	WHT deducted by HCL NZ	24,05,223	1,47,87,420	1,23,82,197	Earlier, the appellant was claiming FTC only in respect of WHT deducted on billing made by taxable units of HCLT. Following the Karnataka High Court decision, FTC is now claimed on the basis of actual WHT deducted by HCL NZ on all units of HCLT.
		2,21,81,646	17,42,40,152	15,20,58,506	

Accordingly, the applicant by way of the present petition seeks to place on record the necessary documents, including details of federal taxes and state taxes paid in USA and details of tax withholding made by HCL (New Zealand) Ltd in support of the enhanced claim of foreign tax credit from Rs. 2.21,81,646 claimed earlier, to Rs. 17,42,40,152, as additional evidence.

Legal Position

It is respectfully submitted that if subsequent events occur, the appellate authority has to examine and evaluate the same and mould the relief accordingly (ref Pasupuleti Venkateswarlu vs. The Motor & General Traders. AIR 1975 SC 1409).

Your Honour's kind attention is invited to the decision of the Delhi High Court in the case of CIT vs Text Hundred India Pvt Ltd: 239 CTR 263 (Del) in that case, the applicant filed certain additional evidences before the Tribunal in support of its claim of certain expenses. which were duly admitted by the Tribunal under Rule-29 of the Income Tax Appellate Tribunal Rules Challenging the order of the Tribunal, the Department filed appeal before the Delhi High Court.

Deciding the appeal in favour of the applicant, their Lordships held that Rule 29 enables the Tribunal to admit any additional evidence which would be necessary to do substantial justice in the matter. Their Lordships further observed that the various procedures, including that relating to filing of additional evidence, is handmade for justice and justice should not be allowed to be choked only because of some inadvertent error or omission on the part of one of the parties to lead evidence

The relevant observations of the Court are reproduced hereunder:

"13. The aforesaid case law clearly lays down a neat principle of law that discretion lies with the Tribunal to admit additional evidence in the interest of justice once the Tribunal affirms the opinion that doing so would be necessary for proper

adjudication of the matter. This can be done even when application is filed by one of the parties to the appeal and it need not to be a suo moto action of the Tribunal. The aforesaid rule is made enabling the Tribunal to admit the additional evidence in its discretion if the Tribunal holds the view that such additional evidence would be necessary to do substantial justice in the matter. It is well settled that the procedure is handmade of justice and justice should not be allowed to be choked only because of some inadvertent error or omission on the part of one of the parties to lead evidence at the appropriate stage. Once it is found that the party intending to lead evidence before the Tribunal for the first time was prevented by sufficient cause to lead such an evidence and that this evidence would have material bearing on the issue which needs to be decided by the Tribunal and ends of justice demand admission of such an evidence, the Tribunal can pass an order to that effect."

(emphasis supplied)

It has similarly been held in the following decisions

- *CIT v Chittosho Motors: ITA 741 of 2010: 11 taxmann.com 81 (P&H).*
- *Atlas Cycle Industries Ltd vs CIT: 133 ITR 231 (P&H) CIT v. Virgin Securities & Credits (P) Ltd 332 ITR 396 (Del)*
- *CIT vs. Hewlett Packard India: 314 ITR 55 (Del)*
- *-CIT vs. Chandra Kant Sahu Bhai: 202 Taxman 262 (Del)*
- *CIT vs. Betterways Finance: ITA 995 of 2009 (Del)*
- *Jatia Investment Co vs. CIT: 206 ITR 718 (Cal)*
- *Electra (Jaipur) Ltd vs. IAC. 26 ITD 236 (Del Trib.)*
- *Y. W. C. A. of India vs. IAC: 29 ITD 620 (Del Trib.)*

It would be appreciated that this is the first appeal before the Hon'ble Tribunal against the impugned assessment order. The aforesaid papers and documents being details of federal taxes and state taxes paid in USA and details of tax withholding made by HCL (New Zealand) Ltd, are now being placed on record in order to substantiate the enhanced claim of FTC made as per the law clarified by the Hon'ble Karnataka High Court (supra) Since the aforesaid evidences placed on record go to the root of the claim, the same need to be admitted for adjudicating the additional grounds of appeal raised for the enhanced claim of FTC amounting to Rs. 15,20,58,506

It is respectfully submitted, therefore, that the additional evidence filed by the applicant may kindly be admitted in terms of the discretion vested in your Honours in terms of Rule 29 of the Income-tax (Appellate Tribunal) Rules, 1963 and taken into consideration while adjudicating the additional grounds of appeal.

We trust the applicant shall merit sympathetic consideration.

An opportunity of being heard is prayed for.”

13.4 In this regard, the assessee filed a written submission which is reproduced as under:

“ The Appellant, in the return of income filed for the relevant assessment year, claimed Foreign Tax Credit ("FTC") amounting to Rs.2,21,81,646 comprising of Rs. 1,68,74,708 paid as Federal Taxes by the US Permanent Establishment ("PE") of the Appellant and Rs.53,06,938 representing withholding tax deducted by foreign entities. The said claim of FTC was restricted to corresponding income on which tax was paid both in India and the foreign country.

Breakup of the aforesaid FTC claim of Rs.2,21,81,646 made by the Appellant in its return of income is as under

<i>S. no.</i>	<i>Particulars</i>	<i>FTC claimed during assessment proceedings</i>	<i>Section under which FTC claimable</i>	<i>Remarks</i>
<i>1</i>	<i>Federal Taxes paid by Us</i>	<i>1,68,74,708</i>	<i>90</i>	<i>FTC claim was restricted to the tax payable in India on such billing</i>
<i>2</i>	<i>State taxes paid by US PE</i>	<i>0</i>	<i>91</i>	<i>FTC was not claimed on account of US State Taxes</i>
<i>3.</i>	<i>WHT deducted by HCL Australia</i>	<i>29,01,715</i>	<i>90</i>	<i>FTC was claimed only in respect of WHT deducted on billing made by taxable units of the Appellants</i>

4	WHT deducted by HCL NZ	24,05,223	90	FTC was claimed only in respect of WHT deducted on billing made by taxable units of the Appellant.
		2,21,81,646		

In the assessment order passed pursuant to directions issued by the Dispute Resolution Panel ("DRP"), the assessing officer allowed FTC of Rs.53,06,938 which pertained to WHT deducted by HCL Australia and HCL New Zealand.

It is submitted that the assessing officer, even after specific directions of DRP, erred in not granting foreign tax credit of taxes paid in USA in respect of STPI units. The relevant extracts of the DRP order are reproduced hereunder:

(1)The next objection of the assessee is that the AO has not entertained the assessee alternate claim of allowing credit for foreign taxes paid for the profit of the foreign undertakings on which deduction u/s 10A has been denied.

This claim of the assessee is justified. The AO is directed to allow the claim of the assessee as per law after due verification

As regard the income from foreign customers, which was subjected to tax in foreign country and included in the total income computed for payment of tax in India, but no tax was paid in India on account of deduction claimed under section 10A of the Act in the return of income filed in India, the Appellant did not claim credit of foreign taxes paid in respective foreign countries.

Pursuant to law as clarified by the Hon'ble Karnataka High Court in the case of Wipro Ltd: [2015] 382 ITR 179 (Kar), the Appellant filed additional ground of appeal along with additional evidence vide application dated 31.05.2016 before this Hon'ble Tribunal, seeking to enhance the claim of foreign tax credit from Rs. 1,92,32,051 claimed earlier to Rs. 10,56,85,829 as follows:

S. NO.	Particulars	FTC claimed during assessment proceedings	Claimable as per Wipro ltd. decision	FTC to be claimed by way of additional ground based on Wipro
1	Tax deducted by HCL Australia	23,61,418	23,61,418	0

2	<i>Tax deducted by HCL NZ</i>	18,341	5,97,865	5,79,524
3	<i>US PE taxes- Federal taxes</i>	1,43,82,084	8,24,68,372	6,80,86,288
4	<i>US PE taxes- State taxes</i>	0	1,61,18,511	1,61,18,51
5	<i>Taxes paid by foreign branches</i>	24,70,208	41,39,662	16,69,454
	<i>Total</i>	1,92,32,051	10,56,85,829	8,64,53,778

Merits of the claim of FTC

The Karnataka High Court in the case of Wipro Ltd (supra), while interpreting the provisions of section 90(1)(a)(ii) providing for relief from double taxation where income of the assessee is chargeable under the Act as well as in the corresponding law in force in the foreign country, held that "Income under section 10A is chargeable to tax under section 4 and is includible in the total income under section 5, but no tax is charged on such income because of the exemption given under section 10A of the Act only for a period of 10 years".

The Hon'ble High Court held that having regard to the language of Article 25 of India-USA DTAA, there is no requirement of capping the amount of FTC claimable in India to the taxes actually paid in India on doubly taxed income and the FTC credit in India can be claimed for the full amount of foreign taxes paid in USA. The only requirement of claiming full FTC in India is that the underlying income per se should not be an exempt income.

Relevant extracts of Article 25 of the India-USA DTAA, which governs the rights of the taxpayer of the resident State to claim credit of taxes paid in the source State, are reproduced hereunder:

"ARTICLE 25

RELIEF FROM DOUBLE TAXATION

1.....

2. (a) Where a resident of India derives income which, in accordance with the provisions of this Convention, may be taxed in the United States, India shall allow as a deduction from the tax on the income of that resident an amount equal to the income-tax paid in the United States, whether directly or by deduction. Such deduction shall not, however, exceed that part of the income-tax (as computed before the deduction is given) which is attributable to the income which may be taxed in the United States

....."

On perusal of paragraph 2(a) of Article 25 of India-USA DTAA, it is evident that payment of actual tax in India is not a condition precedent to allow credit of the foreign tax paid in the USA. Therefore, since amount received from US company is "chargeable to tax" in India on account of it being included in the gross total income of the Indian resident, but no tax is actually paid on the same on account of deduction provided under section 10A/10AA of the Act, foreign tax credit in respect of the same deserves to be allowed.

In contradistinction to the India-USA DTAA, the provisions of Article 23(3) of the India-Canada DTAA provide that foreign tax credit will be allowed in India only when the income is subjected to tax in both countries. Relevant extracts of Article 23 of the India-Canada DTAA are reproduced hereunder:

"3. In the case of India, double taxation shall be avoided as follows:

(a) The amount of Canadian tax paid, under the laws of Canada and in accordance with the provisions of the Agreement, whether directly or by deduction, by a resident of India, in respect of income from sources within Canada which has been subjected to tax both in India and Canada shall be allowed as a credit against the Indian tax payable in respect of such income but in an amount not exceeding that proportion of Indian tax which such income bears to the entire income chargeable to Indian tax"

The distinction between the two DTAA's was noticed and dealt with in detail by the Hon'ble Karnataka High Court in the case of Wipro (supra), wherein it has been held that the condition of income being 'subjected to tax' in both countries is conspicuously absent in the India-USA DTAA and therefore, credit of foreign taxes cannot be denied under the said DTAA if exemption/ deduction in respect of the income is claimed in India.

The Hon'ble Court also held that it is settled position of law that income of a STPI/ SEZ unit, being covered u/s 10A/10AA of the Act, is very much chargeable to tax but it is subsequently excluded from total income as a exemption by the reason of special economic incentive stipulated by these sections.

The Hon'ble Karnataka High Court, accordingly, concluded that merely because exemption has been granted in respect of the taxability of the said source of income, it cannot be postulated that the assessee is not liable to tax and therefore, assessee would be entitled to take credit of income tax paid in a country outside India in relation to income eligible for exemption under section 10A of the Act.

It is pertinent to mention that the Hon'ble Supreme Court in the case of CIT vs Yokogawa India Ltd: [2017] 391 ITR 274 (SC) has categorically held that the provisions of section 10A of the Act are in the nature of deduction. Relevant findings of the apex Court are reproduced hereunder:

12. We have considered the submissions advanced and the provisions of Section 10A as it stood prior to the amendment made by Finance Act. 2000 with effect

from 1.4.2001, the amended Section 10A thereafter and also the amendment made by Finance Act. 2003 with retrospective effect from 1.4.2001.

13. The retention of Section 10A in Chapter III of the Act after the amendment made by the Finance Act, 2000 would be merely suggestive and not determinative of what is provided by the Section as amended, in contrast to what was provided by the un-amended Section. The true and correct purport and effect of the amended Section will have to be construed from the language used and not merely from the fact that it has been retained in Chapter III. The introduction of the word 'deduction' in Section 10A by the amendment, in the absence of any contrary material, and in view of the scope of the deductions contemplated by Section 10A as already discussed, it has to be understood that the Section embodies a clear enunciation of the legislative decision to alter its nature from one providing for exemption to one providing for deductions.

(emphasis supplied)

In light of the ratio laid down by the Hon'ble Supreme Court in the case of Yokogawa (supra) after the judgement passed by the Hon'ble Karnataka High Court in the case of Wipro (supra), wherein the claim under section 10AA has categorically been held to be in the nature of deduction, the case of the Appellant is on even stronger footing inasmuch as the income from SEZ undertakings forms part of Gross Total Income' and only, thereafter, deduction in respect of the same is allowed. Meaning thereby, that it can be nobody's case that the income of the SEZ undertakings which has been subjected to tax outside India is not chargeable to tax in India.

Reliance in this regard is also placed on the decision of Hon'ble Delhi High Court in the case of PCIT vs HCL Comnet Systems and Services Ltd: ITA 549/2022 (order dated 23.11.2023), wherein the Court has followed the view taken by the Karnataka High Court in the case of Wipro Ltd (supra) and allowed the claim of FTC as per the directions of the Hon'ble Karnataka High Court.

Similarly, reliance is placed on the decision of Hon'ble Karnataka High Court in the case of CGI Information Systems and Management Consultants (P) Ltd vs ITO: [2023] 455 ITR 270 (Kar) wherein the AO denied credit of tax withheld in US and Canada on the ground that assessee had availed deduction under section 10A of the Act. The High Court, following the decision rendered by the same Court in the case of Wipro (supra), allowed the credit of taxes paid in US and Canada.

The Mumbai Bench of the Tribunal in the case of Tata Consultancy Service Ltd vs ACIT: [2019] 111 taxmann.com 42 (Mum Trib.), following the aforesaid decision in the case of Wipro Ltd (supra) also held the assessee to be eligible to claim credit of foreign taxes even though no tax was paid on such income in India on account of deduction under section 10A/10AA of the Act.

Similar view has been taken in following cases:

-Canon India Pvt Ltd vs ACIT: ITA No.468/Del/2021 (Del Trib.)

-Infosys BPM Limited vs DCIT: ITA No.492/Bang/2018 (Bang Trib.)

In view of the aforesaid decisions rendered on facts identical to the present case, it is respectfully submitted that the additional ground of appeal filed by the Appellant vide application dated 31.05.2016 deserves to be allowed and assessing officer be directed to grant credit of foreign taxes amounting to Rs. 17,42,40,152 paid by the Appellant in foreign countries.”

13.5 The Spl. Counsel relied upon the orders of the authorities below.

13.6 We have heard both the parties and perused the material available on record.

We find that the additional ground raised by the assessee is legal in nature but subject to verification of facts relating to credit of additional claim of foreign taxes amounting to Rs. 15,20,58,506/- submitted by way of additional evidences by the assessee. In this regard, the Hon’ble Delhi High Court in the case of DCM Benetton India Ltd vs CIT [2008] 173 Taxman 283 (Delhi), has held that even in the event where relevant facts are not on record, the Tribunal can always admit the additional ground and remand the matter to the file of the assessing officer to investigate and determine the facts. Hence, in view of the decision of the Hon’ble Supreme Court in the case of NTPC Limited vs CIT 229 ITR 383(SC) and in the case of DCM Benetton India Ltd vs CIT (supra), the additional grounds raised by the assessee and the additional evidences submitted by the assessee are admitted. However, the additional evidences submitted by the assessee will be subject to the verification of the AO.

13.7 Further, we noticed that Ground no. 11 is a without prejudice ground of the assessee. The appeal was filed on 02.02.2010 and the above without prejudice ground was taken stating that the assessing officer erred on facts and in law in not allowing the credit of foreign taxes paid in the United States of America in respect of doubly taxed income of the taxable STPI Licenses/ Units despite the directions of the Hon'ble DRP in this regard in the order passed under Section 144C(8) of the Act, that the tax credit of taxes paid in vs assessee will be eligible for tax credit as because the AO had partially taxed the income of STPI/ Linces/ Units, which in the return of income had been claimed as exempt. However, subsequent to the decision of the Karnataka High Court in the case of WIPRO Ltd. vs. DCIT [2015] 382 ITR 179 (Kar.), the assessee filed an additional ground being ground no. 11.1 and referred to the observations of the Hon'ble Karnataka High Court that income under section 10A is chargeable to tax under section 4 and is includible in the total income under section 5, but no tax is charged on such income because of the exemption given under section 10A of the Act only for a period of 10 years". Further, it is submitted that the Hon'ble Supreme Court in the case of CIT vs Yokogawa India Ltd: [2017] 391 ITR 274 (SC) has categorically held that the provisions of section 10A of the Act are in the nature of deduction. The relevant findings of the Hon'ble Apex Court are reproduced hereunder:

12. We have considered the submissions advanced and the provisions of Section 10A as it stood prior to the amendment made by Finance Act. 2000 with effect

from 1.4.2001, the amended Section 10A thereafter and also the amendment made by Finance Act. 2003 with retrospective effect from 1.4.2001.

13. The retention of Section 10A in Chapter III of the Act after the amendment made by the Finance Act, 2000 would be merely suggestive and not determinative of what is provided by the Section as amended, in contrast to what was provided by the un-amended Section. The true and correct purport and effect of the amended Section will have to be construed from the language used and not merely from the fact that it has been retained in Chapter III. The introduction of the word 'deduction' in Section 10A by the amendment, in the absence of any contrary material, and in view of the scope of the deductions contemplated by Section 10A as already discussed, it has to be understood that the Section embodies a clear enunciation of the legislative decision to alter its nature from one providing for exemption to one providing for deductions.

In light of the ratio laid down by the Hon'ble Supreme Court in the case of Yokogawa (supra) after the judgement passed by the Hon'ble Karnataka High Court in the case of Wipro (supra), wherein the claim under section 10AA has categorically been held to be in the nature of deduction, the case of the Appellant is on even stronger footing inasmuch as the income from SEZ undertakings forms part of Gross Total Income' and only, thereafter, deduction in respect of the same is allowed. Meaning thereby, that it can be nobody's case that the income of the SEZ undertakings which has been subjected to tax outside India is not chargeable to tax in India.

(emphasis supplied by us)

13.8 Similar question of law was discussed by the Co-ordinate Bench of the Tribunal in the case of HCL Comnet systems and Services Ltd. vs DCIT, in ITA No.-6162/Del/2013 & 835/Del/2014 (Del Trib.). The relevant extract of the said order for A.Y. 2006-07 is reproduced as under:

“41. The assessee has raised an additional ground vide application dated 1.8.2016 and the same reads as under:

“That the Assessing Officer ought to have allowed Foreign Tax Credit of Rs. 56,86,248/ in pursuance to law clarified by the Hon'ble Karnataka High Court in the case of Wipro Ltd 382 ITR 179.”

.....xxx.....

48. *Facts on record show that during the year under consideration, the assessee has PE in USA and accordingly paid tax in USA on the income arising therefrom. The income which was subjected to tax in USA was included in the total income computed for payment of tax in India. However, in respect of the said income earned from USA, the assessee claimed deduction u/s 10A of the Act in the return of income filed in India and did not claim credit of foreign taxes.*

49. Subsequently, the Hon'ble High Court of Karnataka in the case of Wipro Ltd [supra] clarified the law in relation to the claim of foreign tax credit. The Hon'ble High Court, while interpreting the provisions of section 90(1)(a)(ii) of the Act, providing for relief from double taxation where income of the assessee is chargeable under the Act as well as in the corresponding law in force in foreign country has held that income u/s 10A of the Act is chargeable to tax u/s 4 of the Act and is includible in the total income u/s 5 of the Act, but no tax is charged on such income because of exemptions given u/s 10A of the Act only for a period of 10 years.

50. The Hon'ble Karnataka High Court was seized inter alia, with the following substantial question of law:

"Whether the Tribunal was right in holding that the credit for Income tax paid in a country outside India in relation to income eligible for deduction u/s 10A of the Act would not be available u/s 90(1)(a) of the ACT."

51. The Hon'ble High Court observed as under:

.....xxx.....

"39. Thirdly, in cases covered under Section 90 (1)(a)(ii) of the Act it is not a case of the income being subjected to tax or the assessee has paid tax on the income. This applies to a case where the income of the assessee is chargeable under this Act as well as in the corresponding law in force in the other country. Though the income tax is chargeable under the Act, it is open to the Parliament to grant exemptions under the Act from payment of tax for any specified period. Normally it is done as an incentive to the assessee to carry on manufacturing activities or in providing the services. Though the Central Government may extend the said benefit to the assessee in this country, by negotiations with the other countries, they could also be requested to extend the same benefit. If the contracting country agrees to extend the said benefit, then the assessee gets the relief. In another scenario, though the said income is exempt in this country, by virtue of the agreement, the amount of tax paid in the other country could be given credit to the assessee. Thus for the payment of income tax in the foreign jurisdiction, the assessee gets the benefit of its credit in this country.

56. Therefore, it follows that the income under Section 10A is chargeable to tax under Section 4 and is includible in the total income under Section 5, but no tax is charged because of the exemption given under Section 10A only for a period of 10 years. Merely because the exemption has been granted in respect of the taxability of the said source of income, it cannot be postulated that the assessee is not liable to tax. The said exemption granted under the statute has the effect of

suspending the collection of income tax for a period of 10 years. It does not make the said income not leviable to income tax. The said exemption granted under the statute stands revoked after a period of 10 years. Therefore, the case falls under Section 90(1)(a)(ii).

59. A perusal of the aforesaid provision makes it clear that if a resident Indian derives income, which may be taxed in United States, India shall allow as a deduction from the tax on the income of the resident, amount equal to the income tax paid in United States of America, whether directly or by deduction. The conditions mandated in the treaty is that if any "income derived" and "tax paid in United States of America on such income", then tax relief/credit shall be granted in India on such tax paid in United States of America. The said provision does not speak of any income tax being paid by the resident Indian under the Income-tax Act as a condition precedent for claiming the said benefit. Where the Indian resident pays no tax on such income derived, whereas the said income is taxed in the United States, India shall allow as a deduction from the tax on the income of that resident an amount equal to the income-tax paid in the United States. Therefore, this provision is in conformity with Section 90(1)(a)(ii) of the Act ie, the income tax chargeable under the income-tax Act and in the corresponding law in force in United States of America. Therefore, it is not the requirement of law that the assessee, before he claims credit under the Indo US convention or under this provision of Act should pay tax in India on such income. However, the said provision makes it clear that such deduction shall not, however, exceed that part of the income tax (as computed before the deduction is given) which is attributable to the income which is to be taxed in United States Therefore, an embargo is prescribed for giving such tax credit. In other words, the assessee is entitled to such tax credit only in respect of that income, which is taxed in the United States. This provision became necessary because the accounting year in India varies from the accounting year in America. The accounting year in India starts from 1st" of April and closes on 31" of March of the succeeding year. Whereas in America, the 1st¹ of January is the commencement of the assessment year and ends on 31st of December of the same year. Therefore, the income derived by an Indian resident, which falls within the total income of a particular financial year when it is taxed in United States, falls within two years in India. Therefore, while claiming credit in India, the assessee would be entitled to only the tax paid for that relevant financial year in America, ie, the income attributable to that year in America. In other words, the income tax paid in the same calendar year in United States of America is to be accounted for two financial years in India. Of course, this exercise should be done by the assessing authority on the basis of the material to be produced by the assessee."

.....xxx.....

52. In view of the above, we are of the considered view that the facts of the case in hand are in parity with the facts considered by the Hon'ble Karnataka High Court [supra] wherein Article 25 of Indo US DTAA has been elaborately explained by the Hon'ble High Court. The most relevant findings of the Hon'ble High Court are as under:

“Therefore, while claiming credit in India, the assessee would be entitled to only the tax paid for that relevant financial year in America, Le, the income attributable to that year in America. In other words, the income tax paid in the same calendar year in United States of America is to be accounted for two financial years in India. Of course, this exercise should be done by the assessing authority on the basis of the material to be produced by the assessee.”

53. The issue raised by the Id. DR has been answered by the Hon'ble High Court of Karnataka and therefore, needs no separate adjudication. Respectfully following the decision of the Hon'ble Karnataka High Court, we direct the Assessing Officer to consider the claim of foreign tax credit as per the directions of the Hon'ble Karnataka High Court mentioned elsewhere. The assessee is directed to furnish necessary evidences before the Assessing Officer. The additional ground is, accordingly, decided in favour of the assessee.”

13.9 The above view was affirmed by the Hon’ble Delhi High Court in the case of PCIT vs. HCL Comnet systems and Services Ltd in ITA No.- 549/Del/2022 (Del. HC),for A.Y. 2006-07, wherein the Hon’ble Delhi High Court in respect of question no. ‘C’ i.e. whether on facts and circumstances of the case and also on prevailing law, the Hon'ble ITAT was justified in allowing the Foreign Tax Credit of Rs. 2,20,61,027/- by admitting the additional which was held in favour of the assessee. The relevant extract of the order of the Hon’ble Delhi High Court is reproduced as under:

“C. Whether on facts and circumstances of the case and also on prevailing law, the Hon’ble ITAT was justified in allowing the foreign tax credit of Rs. 2,20,61,027/- by admitting the additional ground without giving any opportunity to the Department. [?]”

5. As regards the remaining proposed questions, i.e. 'C', 'D', and 'E', it is evident that 'D' and 'E' are linked to the proposed question 'C'. According to the learned counsel for the respondent/assessee, the proposed questions 'C', 'D', and 'E' are covered by the following judgments rendered by the Karnataka High Court:

(i) Wipro Ltd vs DCIT: (2015) SCC OnLine Kar 9196.

(ii) *PCIT vs Infosys Lid: (2023) 147 taxmann.com 520 (Karnataka).*

(iii) *CGI Information Systems and Management Consultants (P) Ltd vs ITO: (2023) 455 ITR 270 (Kar).*

6. *We have perused the lead judgment of the Karnataka High Court in the Wipro Ltd. case. The facts that obtain therein, are pari materia with the instant appeal.*

7. *We are in respectful agreement with the view taken by the Karnataka High Court in Wipro Ltd. case. The other two judgments referred to hereinabove, only follow the decision in Wipro Ltd. case.*

8. *Therefore, according to us, no substantial question of law arises insofar as proposed questions 'C', 'D', and 'E' are concerned."*

13.10. Further, the Hon'ble Karnataka High Court in the case of WIPRO Ltd. vs.

DCIT (supra) in para 66 had observed as under:

" 66. he said provision provides for deduction of the tax paid in any country from the Indian Income tax payable by him of a sum calculated on such doubly taxed income even though there is no agreement under Section 90 for the relief or avoidance of double taxation. Explanation (iv) defines the expression income tax in relation to any country includes any excess profit tax or business profits tax charged on the profits by the Government of any part of that country or a local authority in that country. Therefore the intention of the Parliament is very clear. The Income Tax in relation to any Country includes Income Tax paid in any part of the country or a local authority. It applies to cases where in a Federal structure a citizen is made to pay Federal Income tax and also the State Income Tax. The Income tax in relation to any country includes income tax paid not only to the Federal Government of that Country, but also any income tax charged by any part of that country meaning a State or a local authority, and the assessee would be entitled to the relief of double taxation benefit with respect to the latter payment also. Therefore, even in the absence of an agreement under Section 90 of the Act, by virtue of the statutory provision, the benefit conferred under Section 91 of the Act is extended to the income tax paid in foreign jurisdictions. India has entered into agreement with the Federal Country and not with any State within that country. In order to extend the benefit of this, relief or avoidance of double taxation, aforesaid explanation explicitly makes it clear that income tax in relation to any country includes the income tax paid to the Government of any part of that country or a local authority in that country. Therefore, even though, India has not entered into any agreement with the State of a Country and if the assessee has paid income tax to that State, the income tax paid in relation to that State is also eligible for being given credit to the assessee in India. Therefore, the argument that in the absence of an agreement between India and the State, the benefit of Section 90 is not available to the assessee is ex-facie illegal and requires to be set aside."

13.11 Therefore, respectfully following the above judicial decisions, we are of the considered view that the assessee would be eligible in respect of taxes paid in foreign countries even if such income is exempt u/s 10A of the Act in the case of the assessee. Therefore, assessee's claim of additional taxes of Rs. 15,20,58,506/- is acceptable in principle. However, as noted by the AO that in the final assessment proceedings, the assessee had made a claim of Rs. 2,21,81,646/- towards foreign tax credit and out of the above, the AO had allowed a sum of Rs. 53,06,938/- but did not allow the balance FTC Claim of Rs. 1,68,74,708/- on account of taxes paid in USA as the assessee did not furnish the necessary documents to substantiate the fact that exactly to which undertakings of the assessee company, the said amount of Rs. 1,68,74,708/-pertains. Therefore, the assessee is directed to submit the said details for getting the above tax credit of Rs. 1,68,74,708/-. Further, as observed by the Co-ordinate Bench of the Tribunal in the case of HCL Comnet Systems & Services Ltd. Vs. DCIT (supra) the assessee while claiming credit in India, would be entitled to only the taxes paid for that relevant financial year in America, i.e., the income attributable to that year in America and keeping in view the above order of the Tribunal the assessee would be entitled to the tax credit as directed in the said order in the case of USA or in the case of the other countries as the case may be. This exercise should be done by the assessing authority on the basis of the

material to be produced by the assessee and in respect of additional evidences filed by the assessee placed at page no. 56 to 430 of the Paper Book filed by the assessee.

13.12 Accordingly, we allow the ground no. 11 and the additional ground no. 11.1 of the appeal with the above observations.

14. The assessee filed an additional ground of appeal on 26.03.2019, wherein it is submitted that AO ought to have restricted the levy of dividend distribution tax ("DDT") on the dividend distributed/ paid to the non-resident shareholder(s), to the rate specified under Article 10 of the relevant Double Taxation Avoidance Agreements ("DTAA") between India and the country of residence of the non-resident shareholder(s) instead of 16.995% charged in terms of section 115-O of the Act.

14.1 The additional ground filed by the assessee is reproduced as under:

"On the facts and circumstances of the case and in law, the assessing officer/ CIT(A) ought to have restricted the levy of dividend distribution tax on the dividend distributed/paid to the non-resident shareholder(s), to the rate specified under Article 10 of the relevant Double Taxation Avoidance Agreements ("DTAA") between India and the country of residence of the non-resident shareholder(s) instead of 14.025% charged in terms of section 115-0 of the Act."

14.2 In respect of this ground, the Hon'ble Bombay High Court at Goa Benches vide its order dated 26.11.2025 in the case of M/s Colorcon Asia Pvt. Ltd. vs. Joint Commissioner of Income Tax, Goa in Tax Appeal no. 5 of 2024 has decided this issue in favour of the assessee. The Spl. Counsel fairly admitted that this ground

was now decided in the favour of the assessee by the aforesaid decision of the Hon'ble Bombay High Court.

14.3 Therefore, respectfully following the order of the Hon'ble Bombay High Court, this ground of appeal is decided in favour of the assessee.

15. Further, the assessee filed an additional ground of appeal on 15.07.2020, wherein it is submitted that AO ought to have allowed deduction of Education Cess computed on returned income, fringe benefit tax and DDT and any other additional amount paid by the Appellant. The said additional ground of appeal is reproduced as under:

"1. That on the facts and circumstances of the case and in law, the assessing officer ought to have allowed, in pursuance to law clarified by the Hon'ble Rajasthan High Court in the case of Chambal Fertilisers and Chemicals Ltd vs JCIT: D.B. ITA No.52/2018 and Hon'ble Bombay High Court in the case of Sesa Goa Ltd vs JCIT: 117 taxmann.com 96 (Bom HC), deduction of Rs.1,67,20,785, being education cess computed on returned income, fringe benefit tax and dividend distribution tax, paid by the Appellant before the due date of filing return of income for the subject assessment year.

2. That on the facts and circumstances of the case and in law, pursuant to law clarified in the case of Chambal Fertilisers and Chemicals Ltd (supra) and Sesa Goa Ltd (supra), the assessing officer also ought to have allowed further deduction in respect of any additional amount paid by the Appellant towards education cess during the financial year relevant to the subject assessment year."

15.1 These additional grounds of appeal were not pressed by the assessee. Hence, these additional grounds of appeal are dismissed as not pressed.

16. Further, the assessee filed an additional ground submitting that the AO ought to have held that income earned from systematic activity of investing funds generated by the eligible undertakings of the assessee in fixed deposits with banks, mutual funds, inter-corporate deposits, etc., were part of 'profit of the business' of such undertakings and were eligible for enhanced deduction under section 10A/ 10AA/ 10B of the Income-tax Act, 1961. This additional ground has been raised by the assessee for the first time before the Tribunal.

16.1 The additional ground filed by the assessee in regard and on 28.01.2019 and the relevant extract of the said submission is reproduced as under:

"Re: Request for admission of additional ground of appeal in terms of Rule 11 of the Income-Tax (Appellate Tribunal) Rules, 1963

The Applicant craves leave to raise the following by way of additional ground of appeal:

"That on the facts and circumstances of the case and in law, the assessing officer/CIT(A) ought to have held that income earned from systematic activity of investing funds generated by the eligible undertakings of the Appellant in fixed deposits with banks, mutual funds, inter-corporate deposits, etc., were part of 'profit of the business' of such undertakings and were eligible for deduction under section 10A of the Income-tax Act, 1961."

The brief facts giving rise to the aforesaid additional ground of appeal are as under:

The Applicant, for the subject assessment year, claimed deduction under section 10A of the Income-tax Act, 1961 ("the Act"). The assessing officer, however, disputed the claim of deduction made by the Applicant under section 10A and only allowed the same in part. In the return of income filed for the subject assessment year and even during the course of assessment proceedings, the Applicant did not claim deduction under section 10A of the Act in respect of income earned from systematic activity of investing funds generated by the eligible undertakings of the Appellant in fixed deposits with banks, mutual funds, inter-corporate deposits, etc.

Recently, the Full Bench of the Hon'ble Karnataka High Court in the case of CIT vs Hewlett Packard Global Soft Ltd: [2018] 403 ITR 453 (Karnataka) vide order dated 30.10.2017, affirmed the decision of Division Bench of the said Court in the case of CIT vs Motorola India Electronics (P) Ltd: 265 CTR 94 (Kar), wherein it was held that though interest received and consideration received from sale of import entitlement does not partake the character of profit and gain from the sale of an article, it is the income which is derived from the consideration realized by export of articles, and therefore, such income is eligible for deduction under section 10B of the Act. The relevant findings of the Full Bench of the Hon'ble Karnataka High Court are reproduced hereunder:

"35. The Scheme of Deductions under Chapter VI-A in Sections 80-HH, 80-HHC. 80-IB. etc. from the 'Gross Total Income of the Undertaking', which may arise from different specified activities in these provisions and other incomes may exclude interest income from the ambit of Deductions under these provisions, but exemption under Section 10-A and 10-B of the Act encompasses the entire income derived from the business of export of such eligible Undertakings including interest income derived from the temporary parking of funds by such Undertakings in Banks or even Staff loans. The dedicated nature of business or their special geographical locations in STPI or SEZs, etc. makes them a special category of assessee entitled to the incentive in the form of 100% Deduction under Section 10-A or 10-B of the Act, rather than it being a special character of income entitled to Deduction from Gross Total Income under Chapter VI-A under Section 80-HH, etc. The computation of income entitled to exemption under Section 10-A or 10-B of the Act is done at the prior stage of computation of Income from Profits and Gains of Business as per Sections 28 to 44 under Part-D of Chapter IV before 'Gross Total Income' as defined under Section 80-B(5) is computed and after which the consideration of various Deductions under Chapter VI-A in Section 80HH etc, comes into picture. Therefore analogy of Chapter VI Deductions cannot be telescoped or imported in Section 10-A or 10-B of the Act. The words 'derived by an Undertaking' in Section 10-A or 10-B are different from 'derived from' employed in Therefore all Profits and Gains of the Undertaking including the incidental income by way of interest on Bank Deposits or Staff loans would be entitled to 100% exemption or deduction under Section 10-A and 10-B of the Act. Such interest income arises in the ordinary course of export business of the Undertaking even though not as a direct result of export but from the Bank Deposits etc., and is therefore eligible for 100% deduction.

36. We have to take a purposive interpretation of the Scheme of the Act for the exemption under Section 10-A/10-B of the Act and for the object of granting such incentive to the special class of assessee selected by the Parliament, the play-in-the-joints is allowed to the Legislature and the liberal interpretation of the exemption provisions to make a purposive interpretation, was also propounded by Hon'ble Supreme Court in the following cases:-

[I] In *Bajaj Tempo Ltd. v. CIT* [1992] 196 ITR 188/62 Taxman 480, the Hon'ble Supreme Court held that:

5.Since a provision intended for promoting economic growth has to be interpreted liberally, the restriction on it, too, has to be construed so as to advance the objective of the section and not to frustrate it. But that turned out to be the, unintended, consequence of construing the clause literally, as was done by the High Court for which it cannot be blamed, as the provision is susceptible of such construction if the purpose behind its enactment, the objective it sought to achieve and the mischief it intended to control is lost sight of. One way of reading it is that the clause excludes any undertaking formed by transfer to it of any building, plant or machinery used previously in any other business. No objection could have been taken to such reading but when the result of reading in such plain and simple manner is analysed then it appears that literal construction would not be proper.

[II] In *R.K. Garg v. Union of India* [1982] 133 ITR 239/[1981] 7 Taxman 53, the Hon'ble Apex Court has held as under:-

8. Another rule of equal importance is that laws relating to economic activities should be viewed with greater latitude than laws touching civil rights such as freedom of speech, religion etc. It has been said by no less a person than Holmes, J., that the legislature should be allowed some play in the joints, because it has to deal with complex problems which do not admit of solution through any doctrinaire or strait-jacket formula and this is particularly true in case of legislation dealing with economic matters, where, having regard to the nature of the problems required to be dealt with, greater play in the joints has to be allowed to the legislature. court should feel more inclined to give judicial deference to legislative judgment in the field of economic regulation than in other areas where fundamental human rights are involved. Nowhere has this admonition been more felicitously expressed than in *Morey v. Doud* [351 US 457: 1 L Ed 2d 1485 (1957)] where Frankfurter, J., said in his inimitable style:

"In the utilities, tax and economic regulation cases, there are good reasons for judicial self-restraint if not judicial deference to legislative judgment. The legislature after all has the affirmative responsibility. The courts have only the power to destroy, not to reconstruct. When these are added to the complexity of economic regulation, the uncertainty, the liability to error, the bewildering conflict of the experts, and the number of times the judges have been overruled by events self-limitation can be seen to be the path to judicial wisdom and institutional prestige and stability."

The Court must always remember that "legislation is directed to practical problems, that the economic mechanism is highly sensitive and complex, that many problems are singular and contingent, that laws are not abstract propositions and do not relate to abstract units and are not to be measured by abstract symmetry"; "that exact wisdom and nice adaption of remedy are not always possible" and that "judgment is largely a prophecy based on meagre and uninterpreted experience"

Every legislation particularly in economic matters is essentially empiric and it is based on experimentation or what one may call trial and error method and therefore it cannot provide for all possible situations or anticipate all possible abuses. There may be

crudities and inequities in complicated experimental economic legislation but on that account alone it cannot be struck down as invalid."

37. *On the above legal position discussed by us, we are of the opinion that the Respondent assessee was entitled to 100% exemption or deduction under Section 10-A of the Act in respect of the interest income earned by it on the deposits made by it with the Banks in the ordinary course of its business and also interest earned by it from the staff loans and such interest income would not be taxable as 'Income from other Sources' under Section 56 of the Act. The incidental activity of parking of surplus funds with the Banks or advancing of staff loans by such special category of assessee covered under section 10-A or 10-B of the Act is integral part of their export business activity and a business decision taken in view of the commercial expediency and the interest income earned incidentally cannot be de-linked from its profits and gains derived by the undertaking engaged in the export of articles as envisaged under section 10-A or section 10-B of the Act and cannot be taxed separately under section 56 of the Act.*

38. *We, therefore, affirm and agree with the view expressed by the first Division Bench of this Court in the case of Motorola India Electronics (P.) Ltd. (supra) and we do not agree with the view taken by the subsequent Division Bench on 10/04/2014 in the present case."*

Considering the law as clarified by Full Bench of the Hon'ble Karnataka High Court (supra), the Applicant by way of present application seeks to enhance the claim of deduction under section 10A of the Act by including income earned from systematic activity of investing funds generated by the eligible undertakings of the Appellant in fixed deposits with banks, mutual funds, inter-corporate deposits, etc., as part of 'profit of the business' of such undertakings, eligible for deduction under section 10A of the Act.

Prayer

The aforesaid ground of appeal is being raised pursuant to the decision of the Full Bench of the Hon'ble Karnataka High Court rendered subsequent to the filing of the appeal. The omission to raise the aforesaid ground of appeal in the original memo of appeal is neither willful nor deliberate.
Further, the additional ground of appeal raises purely legal issues not requiring any fresh investigation into facts.

As such, the additional ground of appeal calls for being admitted and adjudicated on merits as per the discretion vested in your Honours in terms of Rule 11 of the Income-tax (Appellate Tribunal) Rules, 1963 and the decision of the Supreme Court in the case of National Thermal Power Co Ltd vs CIT: 229 ITR 383 (SC) and also the decision in the case of Jute Corporation of India vs CIT: 187 ITR 688 (SC).

Reliance may also be placed on the decision of jurisdictional High Court in the case of DCM Benetton India Limited vs CIT: 173 Taxman 283 (Del), wherein, the Hon'ble High

Court upheld the following finding of the decision of Hon'ble Kerala High Court in the case of CIT vs Kerala State Cooperative Marketing Federation Ltd: 193 ITR 624 (Ker):

"9..... in the event relevant facts are not on record, the Tribunal can always remand the matter to the file of the assessing officer to investigate and determine the facts. It is submitted that the Tribunal ought to have remanded the matter to the file of the assessing officer rather than decline to permit the assessee to raise the additional ground."

The Applicant trusts that the request shall merit sympathetic consideration.

An opportunity of being heard is prayed for."

(emphasis supplied by us)

16.2 Further, during the course of hearing, the assessee submitted as under:

“ The Appellant is a widely held public limited company, engaged in the business of development and export of software and rendering Information Technology enabled services, i.e., IT and ITES through SEZ/ STPI units set up at different points of time across India. Significant portion of the revenue of the Appellant is derived from exports by these undertakings.

The various SEZ/ STPI units being set-up across India are eligible for deduction under sections 10A/ 10AA/ 10B of the Act in respect of the export profits. The Appellant, it is submitted, is a debt-free, cash surplus company which had deployed the surplus funds being generated from the IT/ ITES services performed through SEZ/ STPI units and earned income therefrom. For the subject assessment year, the Appellant did not claim deduction under section 10A/ 10AA/ 10B of the Act in respect of income earned from systematic activity of investing funds generated by the eligible undertakings of the Appellant in fixed deposits with banks, mutual funds, inter-corporate deposits, etc.

*By way of additional ground of appeal, the Appellant, relying upon the **Full Bench decision of the Karnataka High Court** in the case of **CIT vs Hewlett Packard Global Soft Ltd: [2018] 403 ITR 453 (Kar) (FB)** rendered subsequent to filing the captioned appeal, submits that the income earned by the eligible undertakings of the Appellant from systematic activity of investing funds in fixed deposits with banks, mutual funds, inter-corporate deposits, etc. is eligible for deduction under sections 10A/ 10AA/ 10B of the Act and shall be allowed as such.*

It is submitted that section 10AA is a beneficial provision providing for deduction in respect of profits and gains derived by a unit set up in Special Economic Zone (“SEZ unit”) from the export of articles or things or services to be computed in accordance with sub-section (7) of the said section. As per section 10AA(7) of the Act, the profits derived by the SEZ unit from the business of export of services is computed as an amount which bears to the ‘profits of the business’ (of the undertaking), the same proportion as the export turnover bears to the total turnover of the undertaking.

Having regard to the statutory mandate, the profits of the eligible SEZ unit as assessed under the head “profits and gains of business or profession” are required to be apportioned in the ratio of export turnover to total turnover of that unit to arrive at the amount admissible under section 10AA of the Act. In that view of the matter, it is submitted that there is no further requirement on determining whether a particular receipt forming part of “profits and gains of business or profession” has been derived by the eligible SEZ unit from export of software.

Reliance in this regard is placed on the following decisions:

*The question as what can constitute as profits and gains derived by a 100% EOU from the export of articles and computer software came for consideration before **the Karnataka High Court in CIT vs Motorola India Electronics Pvt Ltd: [2014] 265 CTR 94 (Kar)**. In that case, the Revenue challenged the decision of the Tribunal which had held that the interest payable on FDRs was part of the profits of the business of the undertaking and therefore includible in the income eligible for deduction under sections 10A and 10B of the Act. There, the assessee claimed that interest earned on the deposits lying in the EEFC account as well as interest earned on inter-corporate loans given to sister concerns out of the funds of the undertaking, constituted "profits of the business of the undertaking" for purposes of section 10B(4) of the Act. The Karnataka High Court held that “it is clear that, what is exempted is not merely the profits and gains from the export of articles but also the income from the business of the undertaking”. Specific to the question of interest earned by the EOU on the FDRs placed by it and interest earned from the loans given to sister concerns, it was held that although it did not partake the character of profit and gains from the sale of an article, “it is income which is derived from the consideration realized by export of articles.”*

*The **Special bench of the Tribunal** in the case of **Maral Overseas Ltd vs ACIT: [2012] 136 ITD 177 (Indore Trib.) (SB)** on the interpretation of section 10B(4) of the Act [pari materia to sub-section (7) of section 10AA] held that sub-section (4) of section 10B does not require an assessee to establish a direct nexus with the business of the undertaking and once an income forms part of the of the business of the undertaking, the same would be included in the profit of the business of the undertaking. Thus, once an income forms part of the business of the undertaking, there is no further mandate in the provisions of section 10B to exclude the same from the eligible profits.*

*The aforesaid decisions in the case of Motorola India Electronics (supra) and Maral Overseas (supra) have been **affirmed by the Full bench of the Karnataka High Court in the case of CIT vs Hewlett Packard Global Soft Ltd: 403 ITR 453 (Kar) (FB)**. The Full bench, dismissing the appeal of the Revenue, recorded the following pertinent observations:*

“35.The Scheme of Deductions under Chapter VI-A in Sections 80-HH, 80-HHC, 80-IB, etc from the 'Gross Total Income of the Undertaking', which may arise from different specified activities in these provisions and other incomes may exclude interest income from the ambit of Deductions under these provisions, but exemption under Section 10-A and 10-B of the Act encompasses the entire income derived from the business of export of such eligible Undertakings including interest income derived from the temporary parking of funds by such Undertakings in Banks or even Staff loans. The dedicated nature of business or their special geographical locations in STPI or SEZs. etc. makes them a special category of assessee entitled to the incentive in the form of 100% Deduction under Section 10-A or 10-B of the Act, rather than it being a special character of income entitled to Deduction from Gross Total Income under Chapter VI-A under Section 80-HH, etc. The computation of income entitled to exemption under Section 10-A or 10-B of the Act is done at the prior stage of computation of Income from Profits and Gains of Business as per Sections 28 to 44 under Part-D of Chapter IV before 'Gross Total Income' as defined under Section 80-B(5) is computed and after which the consideration of various Deductions under Chapter VI-A in Section 80HH etc. comes into picture. Therefore analogy of Chapter VI Deductions cannot be telescoped or imported in Section 10-A or 10-B of the Act. The words 'derived by an Undertaking' in Section 10-A or 10-B are different from 'derived from' employed in Section 80-HH etc. Therefore, all Profits and Gains of the Undertaking including the incidental income by way of interest on Bank Deposits or Staff loans would be entitled to 100% exemption or deduction under Section 10-A and 10-B of the Act. Such interest income arises in the ordinary course of export business of the Undertaking even though not as a direct result of export but from the Bank Deposits etc., and is therefore eligible for 100% deduction.”In the said case, the Full Bench of the Court affirmed the decision in the case of Motorola India (supra), holding as under:

... ..

*37. On the above legal position discussed by us, we are of the opinion that the Respondent assessee was entitled to 100% exemption or deduction under Section 10-A of the Act in respect of the interest income earned by it on the deposits made by it with the Banks in the ordinary course of its business and also interest earned by it from the staff loans and such interest income would not be taxable as 'Income from other Sources' under Section 56 of the Act. **The incidental activity of parking of surplus funds with the Banks or advancing of staff loans by such special category of assessee covered under section 10-A or 10-B of the Act is integral part of their export business activity and a business decision taken in view of the commercial expediency and the interest income earned incidentally cannot be de-linked from its profits and gains derived by the undertaking engaged in the export of articles as***

envisaged under section 10-A or section 10-B of the Act and cannot be taxed separately under section 56 of the Act.”

(emphasis supplied)

In one of the first judgments, the Delhi High Court in the case of **Snam Progetti S.P.A. vs ACIT: 132 ITR 70 (Del)** observed that:

“The main question for decision is whether the "interest income" could be treated as "business income". The answer to this question has to depend on how we are to consider the interest income derived by the petitioner. No doubt, normally, on the placing of funds in banks on short-term or long-term deposits the interest income derived from those sources would be "income from other sources", but there have been cases in which such income has been treated as income from business, notwithstanding the fact that it is interest income.

..... The question to be seen in such a case is whether the interest income is derived also from what may be described as "business activity". If it is so derived then the mere fact that it is taxed under a different section will make no difference. The approach to the problem has, therefore, to be disassociated from the section under which the tax is imposed on the form of income.

.... **In the present case, the assessee claimed that it has funds which it derived from business and which are used only in business and for no other purpose. If they are spare funds, then they are deposited in banks and, hence, it is clear that this income is also business income. To repeat what was said earlier, the company has not come from Italy to make bank deposits in India but has come to carry on business. If at any time it has spare funds it prefers not to keep the same idle but makes deposits in banks which give some income. This also is, therefore, business income, and for the purpose of set-off has not to be treated as separate from business income.”**

(emphasis supplied)

The decision of the Karnataka High Court in *Motorola India (supra)* was followed by the **Delhi High Court** in the case of **CIT vs Hritnik Exports Pvt Ltd: ITA 219/2014 and PCIT vs Universal precision Screws: ITA 392 of 2015 (Del)**.

In **Riviera Home Furnishing vs ACIT: 237 Taxman 520 (Delhi)**, the Delhi High Court again considered the scope of section 10B of the Act. Allowing the appeal of the assessee and repelling the arguments raised by the Revenue, the Delhi High Court made the following pertinent observations:

“15. In the considered view of the Court, the submissions made on behalf of the Revenue proceed on the basic misconception regarding the true purport

of the provisions of Chapter VIA of the Act and on an incorrect understanding of Section 80A(4) of the Act. The opening words of Section 80A(4) read "Notwithstanding anything to the contrary contained in section 10A or section 10A/ 10AA/ 10B or section 10B or section 10BA or in any provisions of this Chapter ". What is sought to be underscored, therefore, is that Section 80A, and the other provisions in Chapter VIA, are independent of Sections 10A and 10B of the Act. It appears that the object of Section 80A(4) was to ensure that a unit which has availed of the benefit under Section 10B will not be allowed to further claim relief under Section 80IA or 80IB read with Section 80A(4). The intention does not appear to be to deny relief under Section 10B(1) read with Section 10B(4) or to whittle down the ambit of those provisions as is sought to be suggested by Mr. Manchanda. Also, he is not right in contending that the decisions of the High Courts referred to above have not noticed the decision of the Supreme Court in Liberty India. The Karnataka High Court in Motorola India Electronics (P.) Ltd. (supra) makes a reference to the said decision. That decision of the Karnataka High Court has been cited with approval by this Court in Hritnik Exports (P.) Ltd. (supra) and Universal Precision Screws (supra). In Hritnik Exports (P.) Ltd. (supra) the Court quoted with approval the observations of the Special Bench of the ITAT in Maral Overseas Ltd. (supra) that "Section 10A/10B of the Act is a complete code providing the mechanism for computing the 'profits of the business' eligible for deduction u/s 10B of the Act. Once an income forms part of the business of the income of the eligible undertaking of the assessee, the same cannot be excluded from the eligible profits for the purpose of computing deduction u/s 10B of the Act."

(emphasis supplied)

Emphatic reliance is placed on the judgement of the Gujarat High Court in the case of **PCIT vs Dishman Pharmaceuticals & Chemicals Ltd: [2019] 417 ITR 373 (Guj)**, wherein it was held that where once an income forms part of business of 100% EOU of assessee, same cannot be excluded from eligible profits for the computation of deduction under section 10B of the Act. The income being referred to in the said case was in the nature of dividend income, profit on sale of fixed assets, profit on sale of investments, excess provision return back, duty drawback and interest income and the Hon'ble High Court held that the same have direct nexus with the income of the business of the undertaking. The relevant extracts of the judgment are reproduced below:

"60. Thus, sub-section (4) of Section 10B stipulates that deduction under that section shall be computed by apportioning the profits of the business of the undertaking in the ratio of turnover to the total turnover. Thus, notwithstanding the fact that sub-section (1) of Section 10B refers the profits and gains as are derived by a 100% EOU, yet the manner of determining such eligible profits has been statutorily defined in sub-section

(4) of Section 10B of the Act. As per the formula stated above, the entire profits of the business are to be taken which are multiplied by the ratio of the export turnover to the total turnover of the business. Subsection (4) does not require an assessee to establish a direct nexus with the business of the undertaking and once an income forms part of the business of the undertaking, the same would be included in the profits of the business of the undertaking. Thus, once an income forms part of the business of the eligible undertaking, there is no further mandate in the provisions of Section 10B to exclude the same from the eligible profits. The mode of determining the eligible deduction U/S 10B is similar to the provisions of Section 80HHC inasmuch as both the sections mandates determination of eligible profits as per the formula contained therein. The only difference is that Section 80HHC contains a further mandate in terms of Explanation (baa) for exclusion of certain income from the "profits of the business which is, however, conspicuous by its absence in Section 10B. On the basis of the aforesaid distinction, sub-section (4) of Section 10A/10B of the Act is a complete code providing the mechanism for computing the "profits of the business" eligible for deduction u/s. 10B of the Act. Once an income forms part of the business of the income of the eligible undertaking of assessee, the same cannot be excluded from the eligible profits for the purpose of computing deduction u/s 10B of the Act.

62. In view of the aforesaid discussion, we hold that the dividend income, profit on sale of fixed assets, profit on sale of investments, excess provision return back, duty drawback and interest income could be said to have direct nexus with the income of the business of the undertaking. Although it may not partake the character of profit and gain from the sale of article, yet it could be termed as an income derived from the consideration realized by the export articles. In view of the definition of "income from profits and gains" incorporated in sub-section (4), the Tribunal committed no error in granting the benefit of exemption, as contemplated under Section 10B of the Act."

(emphasis supplied)

The **Madras High Court** in their judgement in the case of **California Software Co Ltd vs CIT: Tax Case (Appeal) Nos. 206 & 207 of 2009**, relied on the decision of **Hewlett Packard (supra)** and held that income taxable under section 41(1) of the Act, in the form of reversal of ESOP expenses entries in the books of account, shall also be in the nature of "export income" and therefore, the assessee would be eligible for deduction under section 10A/ 10B of the Act.

Support may also be drawn from the decision of the Delhi bench of the Tribunal in the case of **MMTC Limited vs DCIT in ITA Nos.1415/Del/2011, 217/Del/2005 & 4504/Del/2005** holding income earned from the investment of surplus funds

to be in the nature of business income having regard to the fact that the assessee had earning such income consistently from its business activity.

Similar view has been taken in the following decisions:

- *PCIT vs JP Morgan Services India Pvt Ltd: [2019] ITA 662/2017 (Bom), Revenue's SLP dismissed in [2020] SLP(C) No. 3726/2020 (SC)*
- *CIT vs Hindustan Gum & Chemicals Ltd: 241 Taxman 401 (Cal)*
- *CIT vs Sankhya Technologies (P) Ltd: [2020] 427 ITR 318 (Mad)*
- *Camiceria Apparels India (P) Ltd vs ACIT: [2019] 103 taxmann.com 238 (Mad)*
- *R Systems International Ltd vs ACIT: [2019] ITA No.6506/Del/2016 (Del Trib.)*
- *Affiliated Computer Services of India (P) Ltd vs DCIT: [2020] 114 taxmann.com 178 (Bang Trib.)*
- *Tata Consultancy Services Limited vs DCIT: ITA No.5199/Mum/2019 (Mum Trib.)*

In light of the aforesaid, it is submitted that the income earned from systematic activity of investing funds generated by the eligible undertakings of the Appellant in fixed deposits with banks, mutual funds, inter-corporate deposits, etc. should qualify as business income, assessable under the head "profits and gains of business or profession" and since under section 10A/ 10AA/ 10B, deduction is available with respect to the profits of the business of the undertakings and not restricted to only those income which have first degree nexus with the export of software, such income along with other income under the head "profits and gains of business or profession", should be apportioned in the ratio of export turnover to total turnover of the undertaking to arrive at the amount on which deduction is admissible under section 10A/ 10AA/ 10B of the Act."

16.3 In reply, the Special Counsel for the Revenue submitted as under:

"1. The Assessee, vide application dated 28.01.2019 [for A.Y.s 2006-07 and 2007-08 has raised an additional ground of appeal which reads as under -

"That on the facts and circumstances of the case and in law, the assessing officer/CIT(A) ought to have held that income earned from systematic activity of investing funds generated by the eligible undertakings of the Appellant in fixed deposits with banks, mutual funds, inter-corporate deposits etc. were part of profit of the businesses of such undertakings and were eligible for deduction under section 10A of the Act.

2. Notably, this claim has been made for the first time before the Hon'ble Tribunal and admittedly, was neither made either in the return of income nor during the course of assessment proceedings. Vide the said claim, the Assessee has sought a deduction under Section 10A, of the income earned by it on account of systematic investment activities

undertaken by its eligible undertakings, in fixed deposits with banks, mutual funds, inter-corporate deposits etc.

3. Preliminary Objection

i. At the outset, it is submitted that the Assessee, vide the afore-stated application, filed under Rule 11 of the Income Tax Appellate Tribunal Rules, 1963, has sought indulgence of this Hon'ble Bench to admit a "pure question of fact", which has, admittedly, neither been made in the return of income by the Assessee, nor raised before the AO.

ii. It is submitted that the present application by the Assessee seeks to introduce an additional ground of appeal, which, upon careful perusal, is a pure question of fact requiring fresh investigation and ascertainment of facts. The Revenue most respectfully opposes the admission of this additional ground.

iii. It is submitted that the Assessee is attempting to raise a claim/issue that was never agitated at the assessment stage before the AO nor before the DRP. The original return of income did not contain any such claim, nor were any facts pertaining to this new ground ever placed on record or examined by the lower authorities,

iv. The fundamental principle governing appellate proceedings, particularly before the Hon'ble ITAT, is that the Hon'ble ITAT is a fact-finding appellate authority of last resort. Its primary role is to examine the correctness of the orders passed by the lower authorities based on the facts and legal positions presented before them. It is not a forum for fresh assessment or for embarking upon a new factual inquiry.

v In fact, it would convert the Hon'ble ITAT into a forum of first instance for factual determination, which is contrary to its established jurisdiction and role.

VI. It is submitted that this issue is no longer res integra and has been settled by the Hon'ble Supreme Court in the case of National Thermal Power Co. Ltd. (NTPC) v. CIT. (1998) 97 taxman 358. The Hon'ble Supreme Court has expressly held that the Hon'ble ITAT will not admit fresh factual claims that necessitate new investigation, adduction of evidence, or require a factual determination for the first time at the Tribunal stage in order to ensure adherence to procedural fairness. The present additional ground, being a pure question of fact, squarely falls outside the scope of the NTPC judgment.

vii. That the Assessee had ample opportunity during the assessment proceedings and the first appellate stage to bring all relevant facts and claims to the notice of the respective authorities. The failure to do so at the appropriate stages cannot be rectified by introducing a new factual plea before the ITAT, especially when it goes to the root of the factual matrix.

viii. Therefore, for the reasons stated above, it is humbly prayed that Your Honours may be pleased to dismiss the application for admission of the additional ground of appeal, as it pertains to a pure question of fact never raised or examined by the lower

authorities, and its admission would lead to prejudice to the Revenue and an unfair process.

ix. Without prejudice to what has been stated above, the said application dated 28.01.2019 is conspicuously vague and lacking particulars. While the Assessee has sought deduction of income from systematic investment of funds by eligible undertakings, it has NEITHER specified the quantum of systematic investment made in FD, mutual funds, inter-corporate deposits, NOR mentioned the income generated. The said application is essentially hollow, abstract and extremely nebulous.

x. That, during the course of hearing, the Revenue attempted to reconcile the interest income earned by the Assessee (as disclosed in its return of income and offered for tax under the head "Income from Other Sources") with the interest income earned by the said eligible undertakings. Assuming that the Assessee has already offered the said income to tax under the head "Income from Other Sources", allowing a deduction under Section 10A would tantamount to allowing the Assessee to take a mutually destructive plea, as also demolishing the concept of various heads of income under which the total income is computed.

xi. The vagueness, coupled with the belated presentation of this ground, strongly suggests that it is a mere afterthought and a desperate, last-minute attempt to introduce an issue that was not genuinely pursued or considered during the assessment or first appellate stage. The Assessee had ample opportunity to raise this claim and present relevant facts to the AO and DRP. The failure to do so without any justifiable reason at the appropriate stages should prevent its admission at the ITAT, especially when it has been raised without disclosing any details whatsoever.

4. Jurisprudential fallacy in the additional ground raised by the Appellant

xii. Section 10A aims to promote export-oriented businesses by providing deductions on profits derived from the export of articles or things or computer software. Income from fixed deposits, mutual funds, or other similar financial instruments is income from investments, not directly from the manufacturing production, or export activities of the eligible undertaking

xiii. The source of this income is the financial asset itself (the FD, the mutual fund unit), not the business operations. While the funds might have been "generated by" the eligible undertaking, the income itself is generated by the deployment of those funds in a separate and distinct financial activity.

xiv. Income from FDs and mutual funds is typically considered passive income. It doesn't involve the active business operations, risks, or efforts directly associated with the core business of the eligible undertaking Section 10A is designed to incentivize active business income related to exports.

xv. Section 10A uses the phrase "profits and gains derived from. Indian tax jurisprudence consistently distinguishes "derived from" from "attributable to." "Derived from implies a direct nexus, a proximate cause. Income from investments, even if utilizing business funds, is generally not directly derived from the export

business itself. It is, at best, "attributable to the efficient management of surplus funds, but not directly generated by the core eligible activity.

xvi. The legislative intent behind Section 10A was to encourage and support export-oriented units, fostering foreign exchange earnings through their primary business activities. Extending the benefit to passive investment income would dilute this objective and provide an unintended benefit for capital management rather than core business growth.

xvii. Under the Act, income from investments (like interest from FDs or dividends/gains from mutual funds) typically falls under "Income from Other Sources" or "Capital Gains, not "Profits and Gains of Business or Profession," unless the very business of the assessee is finance or investment. For a manufacturing or software export unit, these are usually distinct heads.

xviii. Allowing Section 10A deduction on investment income could open avenues for misuse. An eligible undertaking might strategically park large sums in FDs or mutual funds to generate tax-free investment income, circumventing the spirit of the deduction which is meant for operational profits.

xix. While the funds might originate from the business, the act of investing them in FDs or mutual funds is a financial decision, not an operational one directly linked to the production, sale, or export process. There is no "operational integration that would make this investment income part of the business profits for Section 10A purposes.

5. Case laws relied upon by the Appellant are wholly inapplicable.

The Appellant in its application under Rule 11, has relied upon the judgement of the Hon'ble High Court of Karnataka in Commissioner of Income Tax v. Hewlett Packard Global Soft Ltd.. [2017] 87 taxmann.com 182 (Karnatakal (FB). In the humble submission of the Revenue, this judgement turns on its own facts and does not aid the case of the Appellant for the following reasons:-

a. The facts of Hewlett Packard (supra) show that the interest income arose from a "business decision taken in view of the commercial expediency and was an "integral part of their export business activity". In the case at hand, as is evident from the application filed by the Appellant, the Appellant's investment activity was not borne out of commercial expediency directly linked to the export business. In fact, it is a systematic investment activity undertaken to earn interest income.

b. Given the absence of complete facts before Your Honours, the following issues will have to be deciphered by the appropriate authority before allowing this deduction- (a) Was the parking of funds truly "temporary and for "current account purposes, or was it a long-term investment strategy?: (b) Were there specific restrictions that forced the parking of funds, or was it simply a general investment of surplus capital? Any attempt by the Appellant to urge these grounds as being covered by the decision in Hewlett Packard (supra) without actually looking and comparing the facts should be castigated for being suggestive of proverbial 'sweeping under the rug.

c. Similarly, the Hewlett Packard (supra) judgment pertains to incidental income from temporary parking of funds and staff loans. The nature and scale of investments in the present case [based on the limited disclosure made by the Assessee in its application under Rule 11], appear to be far broader/more substantial, suggesting a distinct investment activity rather than mere incidental deployment of surplus business funds.

6. The Appellant has also relied upon the decision of the Hon'ble Karnataka High Court in the case of CIT, Central Circle v. Motorola India Electronics (P.) Ltd., [2014] 46 taxmann.com 167 (Karnataka), which formed the premise for the reference to the Full Bench in Hewlett Packard (supra). The findings rendered in Motorola India (supra) are extremely fact specific and cannot be generalized in a 'one size fits all manner. Even in this case, the Hon'ble Karnataka High Court noted specific reasons for parking funds viz. inability to prepay ECBs due to RBI restrictions as well requiring temporary parking until repayment dates. This indicated a strong element of "commercial expediency" directly tied to managing the export business's finances. As stated above, no such common attribute has been brought on record so as to justify the application of this case to the case of the Appellant."

16.4 In rejoinder, the Sr. Counsel for the assessee filed a rejoinder and the relevant extracts are reproduced as under:

“

**Additional Ground
of Appeal:
[AY 2006-07 &
2007-08]**

***Enhanced deduction under section 10A
qua income
from systematic activity of investing
surplus funds***

I. Reply to 'Preliminary Objection'

46. The Appellant, at the outset, vehemently disputes the contention of the Revenue that the claim sought to be made by way of the instant additional ground of appeal is a 'pure question of fact'. The said claim, it is submitted, is a legal issue pertaining to eligibility of the Appellant to claim deduction under section 10A of the Act in respect of income earned from temporary parking of surplus funds generated by an eligible undertaking in fixed deposits, mutual funds, inter-corporate deposits, etc.

*47. The said legal issue was conclusively decided by the Full Bench of the Karnataka High Court in the case of **CIT vs Hewlett Packard Global Soft Ltd [2018] 403 ITR***

453 (Kar) (FB) wherein it was held that income from staff loans and interest on bank deposits from temporary parking of surplus funds would be eligible for deduction under section 10A/ 10B of the Act. **[Refer pages 30-46 of the Case Laws Paper Book]**

48. Since the judgment in **Hewlett Packard** was rendered only on 30.10.2017, i.e., much after assessment for the subject assessment year was completed and appeal was filed before the Hon'ble Tribunal, it is submitted that it was not possible for the Appellant to raise this claim before the lower authorities, as wrongly alleged by the Revenue, and as a result, the Appellant was constrained to raise this legal claim by way of additional ground before the Hon'ble Tribunal. All objections to this effect raised by the Revenue are, thus, baseless and devoid of merit; it is not a case of mere afterthought but subsequent development/ clarification of law, which squarely applies to the case of the Appellant.
49. As regards the contention that no facts have been placed on record before the lower authorities, the Appellant submits as under:
- (i) Firstly, as explained above, the legal issue was raised before the Hon'ble Tribunal for the first time and therefore, there was no occasion to submit relevant details before the lower authorities;
 - (ii) Secondly, the relevant details of income from deployment of funds are duly reported by the Appellant in the audited financial statements and the income-tax return, which were also referred to during the course of hearing before the Hon'ble Tribunal. Kind attention in this regard is invited to page 1023 of the Merits Paper Book Volume 1, being 'Schedule 5 – Income from Other Sources' of the income-tax return filed by the Appellant wherein the relevant amounts are disclosed;
Thirdly, since the issue regarding eligibility of the Appellant to claim deduction under section 10A of the Act qua each separate unit or each license is disputed
 - (iii) and is presently sub-judice, the Appellant was uncertain as to how the computation of deduction is required to be made for furnishing before the Hon'ble Tribunal.

50. *The other objections of the Revenue are contrary to well-settled law, viz., that the Hon'ble Tribunal has power to entertain additional ground of appeal, even though the same was not raised before the lower authorities. Reliance in this regard is placed on the landmark judgment of the Supreme Court in the case of **National Thermal Power Co Ltd vs CIT [1998] 229 ITR 383 (SC)**.*

51. *As regards the contention of the Revenue that the additional claim should not be allowed in absence of facts on record, kind attention of your Honours is invited to the decision of the jurisdictional Delhi High Court in the case of **DCM Benetton India Ltd vs CIT [2008] 173 Taxman 283 (Delhi)**, passed subsequent to the decision in **National Thermal Power Co Ltd (supra)**, wherein it was held that even in the event where relevant facts are not on record, the Tribunal can always admit the additional ground and remand the matter to the file of the assessing officer to investigate and determine the facts. It was held that the Tribunal in the said case ought to have remanded the matter to the file of the assessing officer rather than decline to permit the assessee to raise the additional ground.*

52. *It has similarly been held by the Kerala High Court in the case of **CIT vs Kerala State Cooperative Marketing Federation Ltd [1992] 193 ITR 624 1 (Ker)**.*

Re.: Allowability of modification/ variation of claim made in original return of income

53. *Without prejudice and in addition to the above, it is further submitted that the present case of the Appellant does not involve making a fresh claim, rather, it only involves enlargement/ modification/ variation of the claim(s) as deduction under section 10A of the Act already made in the original return of income. In other words, the claim of deduction under section 10A of the Act was made in the return of income itself and was, therefore, very much before assessing officer. The Appellant is merely seeking to modify its claim of deduction under section 10A*

after including income earned from temporary parking of surplus funds generated by an eligible undertaking in fixed deposits, mutual funds, inter-corporate deposits, etc., as part of “profits of the business of the undertaking”. The Appellant did not, therefore, making an altogether new claim for the first time.

54. *Attention is invited to the decision of the Delhi High Court in the case of **PCIT vs E-Funds International India (P) Ltd [2017] 379 ITR 292 (Del)**, wherein it was held that the assessee was permitted to revise the claim of deduction under section 10A of the Act during the course of assessment proceedings since it was merely a case of revision of the claim of deduction and not a fresh claim being made by the assessee for the first time. Relevant extracts of the decision are as under:*

“17. In all the aforementioned decisions cited by learned counsel for the assessee, the High Court has considered the effect of the decision of the Supreme Court in Goetze (India) Ltd.(supra). The common thread running through the ratio in all the decisions of the High Courts is that while an Assessing Officer may not be entitled to grant a deduction or an exemption on the basis of a revised computation of income, there was no such fetter on the appellate authorities. This was recently reiterated by this court in a decision dated August 25, 2015, in I.T.A. No. 644 of 2015 (Pr. CIT v. Western India Shipyard Ltd. [2015] 379 ITR 289 (Delhi)). In Sam Global Securities Ltd. (supra), this court pointed out that the power of the Tribunal in dealing with appeals was expressed in the widest possible terms and the purpose of assessment proceedings was to assess the correct tax liability. The court noted that “courts have taken a pragmatic view and not a technical view as what is required to be determined is the taxable income of the assessee in accordance with law”. In Influence (supra) a similar approach was adopted when the Assessing Officer in that case refused to accept the revised computation submitted beyond the time limit for filing the revised return under section 139(5) of the Act. This court noted that the decision in Goetze (India) Ltd. (supra) “would not apply if the assessee had not made a new claim but had asked for re-computation of the deduction”.

18. *Turning to the facts of the present case, as rightly noted by the Income-tax Appellate Tribunal itself, this is not a case where any new claim for deduction*

under section 10A of the Act has been made by the assessee. This claim had been made in the original return itself. It is only the figure of profit that was changed in the revised computation as a result of wrongly showing a receipt in USDs without converting it into rupees. The Income-tax Appellate Tribunal has, in fact, remitted the matter back to the file of the Assessing Officer to compute the deduction in accordance with law.

19. The court does not see any prejudice being caused to the Revenue as a result of the above directions. It is consistent with the law explained by this court in the above decisions after considering the effect of the decision of the Supreme Court in Goetze (India) Ltd. (supra). Consequently, as regards the issue of the deduction under section 10A of the Act, the court declines to frame a question.”

55. *The aforesaid judgment was followed by the Delhi High Court in the case of **PCIT vs Oracle (OFSS) BPO Services Ltd [2019] 102 taxmann.com 396 (Del)** wherein it was held that where the assessee had filed a revised computation of income making suo motu disallowance and allowance of certain amounts from business income which resulted in revised computation of deduction claimed under section 10A, since it was not a case where any new claim for deduction under section 10A was made and there was merely re-computation of claim already made by the assessee, such revised computation was to be accepted by the assessing officer. The High Court categorically recorded as under:*

“16. Thus a distinction was drawn between a new claim, which is barred and not permissible and a request or prayer made by the assessee for re-computation of the deduction already claimed. Latter was permissible and not barred in terms of the decision in the case of Goetze (India) Ltd. (supra).”

56. *Further, in **JCIT vs Hero Honda Finlease Ltd 115 TTJ 752 (Del Trib.) (TM)**, the Third Member of the Delhi Tribunal held as under:*

*"I have carefully considered the questions, the orders of the IT authorities and the rival contentions. **The precise difference between the two learned Members is regarding the question whether the CIT(A) ought to have first decided the question of entertainability of the assessee's higher claim of depreciation by a letter and not by a revised return, before deciding the merits of the claim.** In Goetze (India) Ltd. vs. CIT (2006) 204 CTR (SC) 182: (2006) 284 ITR 323 (SC), the Supreme Court held that the assessee can make a claim for deduction, which has not been claimed in the return, only by filing a revised return within the time allowed. In the same decision, it was made clear that the power of the Tribunal to admit an additional ground under s. 254 is not affected by its decision. It was however clarified that the case was concerned with only the power of the assessing authority and not the appellate authority. Under s. 250(5), the CIT(A) has the power to allow the appellant to go into any ground of appeal not specified in the grounds of appeal if he satisfied that the omission of the ground from the form of appeal was not wilful and unreasonable. Dealing with such a power, the Bombay High Court in CIT vs. Prabhu Steel Industries (P) Ltd. (1988) 171 ITR 530 (Bom), held that where a claim for special deduction was made by the assessee not in his return but in the course of the assessment proceedings and the ITO failed to consider the same, it was open to the AAC to entertain the claim.*

*In CIT vs. Kanpur Cool Syndicate (1964) 53 ITR 225 (SC), it was held by the Supreme Court that the powers of the CIT(A) sitting in appeal over an assessment were plenary and conterminous with those of the AO and that he can do what the ITO can do and also direct him to do what he has failed to do. In the light of the law laid down in this judgment by the Supreme Court, it was open to the CIT(A) to consider the assessee's claim on merits by virtue of his co-extensive power over the assessment proceedings and also by virtue of s. 250(5). **That apart, the judgment of the Supreme Court in Goetze (supra) is distinguishable on facts because in that case the claim was made for the first time in the letter filed by the assessee in the course of the assessment proceedings whereas in the present case the claim of depreciation on the trucks @ 20 per cent was already made in the return of income and it was merely enlarged to 40 per cent on the footing that the assessee was running the trucks on hire. It cannot be said to be an entirely new claim made for the first time in the letter filed by the assessee in the course of the assessment proceedings. The CIT(A) therefore committed no error in dealing with the assessee's appeal on merits.** Moreover,*

the AO himself has examined the claim on merits though he earlier held that the claim was not entertainable and the letter was non est. A decision having been given by him on merits it was open to the CIT(A) to deal with the merits. I, therefore, agree with the learned AM that the CIT(A) was not precluded from dealing with the assessee's claim for higher depreciation on merits."

(emphasis supplied)

57. *Reliance in this regard is placed on the recent decision passed by Mumbai bench of the Tribunal in the case of **Tata Consultancy Services Limited vs DCIT in ITA No.5199/Mum/2019 (Mum Trib.)**, wherein the assessee during the course of assessment proceedings, claimed enhanced deduction under section 10AA of the Act qua interest income. The assessing officer denied the benefit of deduction under section 10AA on such interest income for the reason that such claim was not made by filing revised return of income. The Tribunal held that the assessee was not making a fresh claim, instead it was a case of recomputation of the deduction already claimed in return of income. The Tribunal further held that the powers of the Tribunal are not impinged in entertaining claim not made in the return of income or revised return of income. On merits, the Tribunal allowed the enhanced claim of deduction under section 10AA of the Act qua interest income following the **Full Bench decision of Karnataka High Court** in the case of **Hewlett Packard 403 ITR 453 (Kar) (FB)**.*
58. *The assessee in the aforesaid case, i.e., TCS, is a direct competitor of the Appellant and engaged in the same line of business; the facts of this case bear striking similarity and therefore, the favourable decision passed by Mumbai bench of the Tribunal squarely applies to the case of the Appellant as well.*
59. *In view of aforesaid discussion, it is respectfully submitted that the claim of enhanced deduction under section 10AA of the Act being made by way of filing additional ground before your Honour calls for being allowed.*

Reply to 'Jurisprudential fallacy in the additional ground raised'

60. *The contentions of the Revenue under this head are without merit and directly contrary to binding judicial precedents, as explained hereunder:*
61. *While there is no dispute that the intent behind insertion of section 10A of the Act was to promote export-oriented businesses by providing specific deductions, that itself cannot govern the quantum of deduction available under the said section, which has to be necessarily computed in accordance with the statutory provisions.*
62. *Reference in this regard is made to sub-sections (1) and (4) of section 10A of the Act, which provide as under:*

*“10A. (1) Subject to the provisions of this section, **a deduction of such profits and gains as are derived by an undertaking from the export of articles or things or computer software** for a period of ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce such articles or things or computer software, as the case may be, shall be allowed from the total income of the assessee*

.....

***(4) For the purposes of sub-sections (1) and (1A), the profits derived from export of articles or things or computer software shall be the amount which bears to the profits of the business of the undertaking,** the same proportion as the export turnover in respect of such articles or things or computer software bears to the total turnover of the business carried on by the undertaking.”*

(emphasis supplied)

63. *The Appellant submits that perusal of the aforesaid sections make it amply clear that for the purposes of section 10A of the Act, ‘profits derived from export’ mean ‘profits of the business of the undertaking’ in the ratio of export turnover by total turnover. Thus, so long as income is generated from the business of the undertaking, the assessee is eligible to claim deduction under the said section.*
64. *The distinction sought to be made by the Revenue between ‘derived from’ and*

'attributable to' is not relevant for the purposes of section 10A of the Act; it has also categorically been held so by the Full Bench of the Karnataka High Court in the case of Hewlett Packard (supra). Relevant extracts of the judgment are reproduced hereunder:

“34. We are of the considered opinion that the above referred decisions relied upon by the learned counsel for the Revenue, Mr. Aravind do not cover the cases under Sections 10-A and 10-B of the Act which are special provisions and complete code in themselves and deal with profits and gains derived by the assessee of a special nature and character like 100% Export Oriented Units (EOUs) situated in Special Economic Zones (SEZs), STPI, etc., where the entire profits and gains of the entire Undertaking making 100% exports of articles including software as is the fact in the present case, the assessee is given 100% deduction of profit and gains of such export business and therefore incidental income of such undertaking by way of interest on the temporarily parked funds in Banks or even interest on staff loans would constitute part of profits and gains of such special Undertakings and these cases cannot be compared with deductions under Sections 80-HH or 80-IB in Chapter VI-A of the Act where an assessee dealing with several activities or commodities may inter alia earn profits and gains from the specified activity and therefore in those cases, the Hon'ble Supreme Court has held that the interest income would not be the income "derived from" such Undertakings doing such special business activity.

35. The Scheme of Deductions under Chapter VI-A in Sections 80-HH, 80-HHC, 80-IB, etc from the 'Gross Total Income of the Undertaking', which may arise from different specified activities in these provisions and other incomes may exclude interest income from the ambit of Deductions under these provisions, but exemption under Section 10-A and 10-B of the Act encompasses the entire income derived from the business of export of such eligible Undertakings including interest income derived from the temporary parking of funds by such Undertakings in Banks or even Staff loans. The dedicated nature of business or their special geographical locations in STPI or SEZs. etc. makes them a special category of assessee entitled to the incentive in the form of 100% Deduction under Section 10-A or 10-B of the Act, rather than it being a special character of income entitled to Deduction from Gross Total Income under Chapter VI-A under Section 80-HH, etc. The computation of income entitled to exemption under Section 10-A or 10-B of the Act is done at the prior stage of computation of Income from Profits and Gains of Business as per Sections 28 to 44 under Part-D of Chapter IV before 'Gross Total Income' as defined under Section 80-B(5) is computed and after which the consideration of various Deductions under Chapter VI-A in Section 80HH etc. comes into picture. Therefore analogy of Chapter VI Deductions cannot be telescoped or imported in Section 10-A or 10-B of the Act. The words 'derived by an Undertaking' in Section 10-A or 10-B are different from 'derived from' employed in Section 80-HH etc. Therefore all Profits and Gains of

the Undertaking including the incidental income by way of interest on Bank Deposits or Staff loans would be entitled to 100% exemption or deduction under Section 10-A and 10-B of the Act. Such interest income arises in the ordinary course of export business of the Undertaking even though not as a direct result of export but from the Bank Deposits etc., and is therefore eligible for 100% deduction.

.....

37. On the above legal position discussed by us, we are of the opinion that the Respondent assessee was entitled to 100% exemption or deduction under Section 10-A of the Act in respect of the interest income earned by it on the deposits made by it with the Banks in the ordinary course of its business and also interest earned by it from the staff loans and such interest income would not be taxable as 'Income from other Sources' under Section 56 of the Act. The incidental activity of parking of Surplus Funds with the Banks or advancing of staff loans by such special category of assessee covered under Section 10-A or 10-B of the Act is integral part of their export business activity and a business decision taken in view of the commercial expediency and the interest income earned incidentally cannot be de-linked from its profits and gains derived by the Undertaking engaged in the export of Articles as envisaged under Section 10-A or Section 10-B of the Act and cannot be taxed separately under Section 56 of the Act.”

65. *The Hon’ble Delhi High Court in the case of **CIT vs Hritnik Exports Private Limited in ITA 219/2014 and 239/2014** has held that all business profits of the undertaking are eligible for deduction and it is not necessary to show that they have a "direct nexus" with the undertaking. It was held as under:*

“Sub-section (4) of s. 10B does not require an assessee to establish a direct nexus with the business of the undertaking and once an income forms part of the business of the undertaking, the same would be included in the profits of the business of the undertaking. Thus, once an income forms part of the business of the eligible undertaking, there is no further mandate in the provisions of section 10B to exclude the same from the eligible profits.”

66. *In the case of **Pr. CIT vs Universal Precision Screws in ITA 392/2015**, the Hon’ble Delhi High Court upheld the finding of the Tribunal that FDR interest on margin kept with bank qualifies for deduction under section 10B of the Act. The relevant extracts of the decision are reproduced hereunder:*

*“the decision of the ITAT that such interest bears the requisite characteristic of business income and has nexus to the business activities of the Assessee cannot be faulted. In other words, **interest earned on the FDRs would form part of the “profits of the business of the undertaking”** for the purposes of computation of the profits derived from export by applying formula under Section 10B(4) of the Act.”*

67. *The Hon 'ble Karnataka High Court in case of **CIT vs Motorola India Electronics (P) Ltd [2014] 265 CTR 94 (Kar)** upheld the decision passed by the Bangalore bench of the Tribunal in **ACIT vs Motorola India Electronics Private Limited 114 ITD 387** acknowledging the distinction in the computation mechanism given in section 10A(4) of the Act vis-à-vis the language of section 10A(1) of the Act.*
68. *In the said decision in **Motorola India Electronics (P) Ltd (supra)**, it was held that interest earned on deposits held in EEFC account from export profits and on inter-corporate loans, pending utilization of funds for repayment of external commercial borrowings, can be considered to have close nexus with the business activity of the assessee and accordingly, interest income was to be regarded as receipts derived from the business of the undertaking. The relevant extracts from the said decision are reproduced below:*

*“.....The above section supports the argument of the learned counsel for assessee. The section has undergone a change. Earlier, it was an exemption section and income from these undertakings which are covered by this section did not form part of total income. From this particular year, though the section appears in Chapter III, which classifies incomes which do not form part of total income, a deduction from business income from the undertaking is granted by including the special provision. **Another important feature in sub-s. (4) is that the methodology of arriving at the export profits of the business of the undertaking is given in a formula, as in the case of s. 80HHC and it shall be the same proportion as the export turnover bears to total turnover in respect of such articles or things or computer software. The word "shall" has been used to make it mandatory. Another important feature is that the terminology used in sub-s. (4) is "profits of the business" of the undertaking in contradistinction***

to the words "profits and gains derived by the assessee" from a 100 per cent export oriented undertaking.

8.4 In s. 80IA, the term profits and gains from the business has been used. Similar terminology has been used in many other sections such as s. 80JJ or 80JJA, etc., whereas under s. 80I and other sections the terminology used is "profits and gains derived from industrial undertaking". **The term "from the business of" is much wider than the term "derived from industrial undertaking". Keeping this distinction in mind, we have to necessarily hold that the entire profits derived from the business of undertaking should be taken into consideration, while computing the eligible deduction under s. 10B/10A of the Act, by applying the mandatory formula...".**

(emphasis supplied)

69. *It is pertinent to note that the aforesaid decision was upheld by the Full Bench of the Karnataka High Court in the case of **CIT vs Hewlett Packard Global Soft Ltd (supra)**.*
70. *The contentions of the Revenue on this score, thus, deserve to be rejected.*

Reply to 'Case laws relied upon by the Appellant are wholly inapplicable'

71. *The Appellant respectfully submits that it is a service-oriented company employing approximately 11,000 personnel during the relevant financial year in its various undertakings. A significant portion—over 50%—of the monthly operating expenses of the undertakings is attributed to employee salaries, which are essential and non-discretionary. In addition to salaries, the various undertakings incur recurring expenses, such as, office rentals, electricity, transportation, and communication costs, all of which are critical to maintaining its day-to-day operations. These expenditures are mandatory and must be paid in cash every month as a part of the business activities of the undertakings. On the other hand, the revenue stream of various undertakings is derived from customer billing closely tied to project execution, milestone achievements, onboarding of new projects, and ramp-up activities, which is inherently unpredictable, volatile and subject to fluctuations and influenced by external factors beyond the*

company's control. Therefore, to sustain its business operations and honor its financial commitments, the Appellant must maintain sufficient cash reserves at all times to meet all business exigencies.

72. To ensure financial resilience and uninterrupted operations, the Appellant maintains contingency cash reserves equivalent to approximately 6 to 7 months of operating expenses of the undertakings.
73. Such prudent reserve management is a well-established practice across the IT services industry, as reflected in the contingency reserve strategies adopted by peers in the industry as detailed in the table below.

FY ending on	HCL Technologies (Appellant)			Infosys			TCS		
	Total treasury investments	Monthly operating expense	No. of months operating expenses maintained as treasury investments	Total treasury investments	Monthly operating expense	No. of months operating expenses maintained as treasury investments	Total treasury investments	Monthly operating expense	No. of months operating expenses maintained as treasury investments
	A1	A2	A1/A2	B1	B2	B1/B2	C1	C2	C1/C2
31st March 2006	1,473	173	8.5	4,155	537	7.7	2,135	684	3.1
31st March 2007	1,735	234	7.4	6,346	783	8.1	3,809	915	4.2
31st March 2008	1,886	297	6.4	7,393	936	7.9	5,037	1,164	4.3
31st March 2009	1,449	334	4.3	10,044	1,171	8.6	7,541	1,400	5.4
31st March 2010	1,765	316	5.6	14,433	1,215	11.9	11,290	1,404	8.0
Average balances for last 5 years			6.4			8.8			5.0

74. The parking of contingency funds generated from export was prudent business activity of the undertakings and it is not a case of an independent business, divorced and de-linked from the STP undertakings, as sought to be canvassed by the Revenue.
75. The Appellant also places reliance on the following judgments wherein similar activity of parking temporary surplus funds generated from export activity has been held to be profits from business, eligible for deduction under section 10A/ 10B/ 10AA of the Act:
- Maral Overseas Ltd vs ACIT: [2012] 136 ITD 177 (Indore Trib.) (SB); affirmed by the Delhi High Court in CIT vs Hritnik Exports Pvt Ltd (supra)
 - Riviera Home Furnishing vs ACIT: 237 Taxman 520 (Del)

- *PCIT vs Dishman Pharmaceuticals & Chemicals Ltd: [2019] 417 ITR 373 (Guj)*
 - *California Software Co Ltd vs CIT: Tax Case (Appeal) Nos. 206 & 207/2009 (Mad HC)*
 - *MMTC Limited vs DCIT in ITA Nos.1415/Del/2011, 217/Del/2005 & 4504/Del/2005*
 - *PCIT vs JP Morgan Services India Pvt Ltd: [2019] ITA 662/2017 (Bom), Revenue’s SLP dismissed in [2020] SLP(C) No. 3726/2020 (SC)*
 - *CIT vs Hindustan Gum & Chemicals Ltd: 241 Taxman 401 (Cal)*
 - *CIT vs Sankhya Technologies (P) Ltd: [2020] 427 ITR 318 (Mad)*
 - *Camiceria Apparels India (P) Ltd vs ACIT: [2019] 103 taxmann.com 238 (Mad)*
 - *R Systems International Ltd vs ACIT: [2019] ITA No.6506/Del/2016 (Del Trib.)*
 - *Affiliated Computer Services of India (P) Ltd vs DCIT: [2020] 114 taxmann.com 178 (Bang Trib.)*
76. *It is also worthwhile to note the ratio of the Supreme Court judgment in the case of **CIT vs Yokogawa India Ltd [2017] 391 ITR 274 (SC)** wherein it was held that deduction under section 10A of the Act has to allowed qua the ‘total income of the undertaking’, without bifurcating such income of the undertaking into different heads of income provided in Chapter IV of the Act/ before embarking upon determination of income head-wise.*
77. *It is, thus, submitted that the enhanced claim of deduction under section 10A of the Act raised by way of additional ground of appeal is within the four corners of law, supported by various judicial precedents and deserves to be allowed in favour of the Appellant.”*

(emphasis supplied by us)

16.5 We have heard both the parties and perused the material available on record. The assessee raised this additional ground for the first time before the Tribunal, which has been opposed by the Spl. Counsel for the Revenue, that the present

additional ground of appeal is not a question of law but a question of fact which cannot be admitted for the first time before the Tribunal. Further, it has been submitted by the Spl. Counsel for that it has neither specified the quantum of systematic investment made in FD, mutual funds, inter-corporate deposits, nor mentioned the income generated and the said application was essentially hollow, abstract and extremely nebulous. It was further submitted that assuming that the Assessee had already offered the said income to tax under the head "Income from Other Sources", allowing a deduction under Section 10A would tantamount to allowing the Assessee to take a mutually destructive plea, as also demolishing the concept of various heads of income under which the total income is computed. Further, it was submitted that the source of this income was the financial asset itself (the FD, the mutual fund unit), and not the business operations of the assessee and that while the funds might have been "generated by" the eligible undertaking, the income itself was generated by the deployment of those funds in a separate and distinct financial activity. It was further submitted that given the absence of complete facts before the Tribunal, the following issues will have to be deciphered by the appropriate authority before allowing this deduction- (a) Was the parking of funds truly "temporary and for "current account purposes, or was it a long-term investment strategy?: (b) Were there specific restrictions that forced the parking of funds, or was it simply a general investment of surplus capital? and attempt by the assessee to urge

these grounds as being covered by the decision in Hewlett Packard (supra) without actually looking and comparing the facts should be castigated for being suggestive of proverbial 'sweeping under the rug'.

16.6 On the other hand, the Sr. Counsel submits that, the relevant details of income from deployment of funds are duly reported by the assessee in the audited financial statements and the income-tax return, which were also referred to during the course of hearing before the Tribunal and attention in this regard was invited to page 1023 of the Merits Paper Book Volume 1, being 'Schedule 5 – Income from Other Sources' of the income-tax return filed by the assessee wherein the relevant amounts are disclosed. Further, it was submitted that since the issue regarding eligibility of the assessee to claim of deduction under section 10A of the Act qua each separate unit or each license is disputed and is presently sub-judice, the assessee was uncertain as to how the computation of deduction is required to be made for furnishing before the Tribunal. It was further submitted that as regards the contention of the Revenue that the additional claim should not be allowed in absence of facts on record, the Sr. Counsel relied upon the decision of the jurisdictional Delhi High Court in the case of DCM Benetton India Ltd vs CIT [2008] 173 Taxman 283 (Delhi), passed subsequent to the decision in National Thermal Power Co Ltd (supra), wherein it was held that even in the event where relevant facts are not on record, the Tribunal can always admit the additional ground and remand the matter to the file of the

assessing officer to investigate and determine the facts. It was submitted by the Ld. Counsel that it was held by the Hon'ble High Court that the Tribunal in the said case ought to have remanded the matter to the file of the assessing officer rather than decline to permit the assessee to raise the additional ground. It was further submitted that the court noted that "courts have taken a pragmatic view and not a technical view as what is required to be determined is the taxable income of the assessee in accordance with law". In the case of PCIT vs. E-Funds International India (P) Ltd. (supra) a similar approach was adopted by the Hon'ble Delhi High Court when the Assessing Officer in that case refused to accept the revised computation submitted beyond the time limit for filing the revised return under section 139(5) of the Act. The Hon'ble court quoted the decision in the case in Influence (supra), which held that the decision in Goetze (India) Ltd. (supra) "would not apply if the assessee had not made a new claim but had asked for re-computation of the deduction". The assessee submits that perusal of the aforesaid sections make it amply clear that for the purposes of section 10A of the Act, 'profits derived from export' mean 'profits of the business of the undertaking' in the ratio of export turnover by total turnover and thus the entire 'profits of the business of the undertaking' has to be considered and not as profit derived from its export business as laid down in section 80HHC and 80HHE of the Act. The Spl. Counsel submitted that so long as income was

generated from the business of the undertaking, the assessee was eligible to claim deduction under the said section.

16.7 In view of the discussion and relying upon the decision of the Hon'ble Delhi High Court in the case of DCM Benetton India Ltd. Vs. DCIT (supra), we admit this additional ground of appeal. Further, we also find support for admitting this additional ground of appeal in view of the decision of the Hon'ble Delhi High Court in the case of PCIT vs. E-Funds International India (P) (supra), that the claim made in this additional ground of appeal is not a new claim but a re-computation of deduction under section 10A of the Act. Further, we are satisfied that the aforesaid ground of appeal is being raised pursuant to the decision of the Full Bench of the Hon'ble Karnataka High Court rendered subsequent to the filing of the appeal and we are satisfied that the omission to raise the aforesaid ground of appeal in the original memo of appeal is neither willful nor deliberate.

16.8 In this regard, the objection of the special counsel that before allowing the deduction it has to be seen that (a) Was the parking of funds truly "temporary and for "current account purposes, or was it a long-term investment strategy?: (b) Were there specific restrictions that forced the parking of funds, or was it simply a general investment of surplus capital? and attempt by the assessee to urge these grounds as being covered by the decision in Hewlett Packard (supra) without actually looking and comparing the facts should be castigated for being suggestive of proverbial

'sweeping under the rug has been carefully perused, but not found to be acceptable even though the Hon'ble Karnataka High Court in the case of CIT vs Hewlett Packard Global Soft Ltd (supra) held that the income other than the eligible business under section 10A of the Act should be incidental, but the subsequent judgments of the Hon'ble Delhi High Court in the case of CIT Vs. Riviera Home Furnishing vs ACIT: 237 Taxman 520 (Delhi), while interpreting pari – materia section 10B (4) of the Act the view of the Hon'ble Karnataka High Court in the case of Motorola India Electronics (P.) Ltd. (supra) held as under:

"The Karnataka High Court in Motorola India Electronics (P.) Ltd. (supra) makes a reference to the said decision. That decision of the Karnataka High Court has been cited with approval by this Court in Hritnik Exports (P.) Ltd. (supra) and Universal Precision Screws (supra). In Hritnik Exports (P.) Ltd. (supra) the Court quoted with approval the observations of the Special Bench of the ITAT in Maral Overseas Ltd. (supra) that "Section 10A/10B of the Act is a complete code providing the mechanism for computing the 'profits of the business' eligible for deduction u/s 10B of the Act. Once an income forms part of the business of the income of the eligible undertaking of the assessee, the same cannot be excluded from the eligible profits for the purpose of computing deduction u/s 10B of the Act."

(emphasis supplied by us)

16.9 Similar view has been held by the Hon'ble Gujarat High Court in the case of PCIT Vs. Dishman Pharmaceuticals & Chemical Ltd. (supra) which held that once an income forms part of the business of the eligible undertaking, there is no further mandate in the provisions of Section 10B to exclude the same from the eligible profits and held that dividend income, profit on sale of fixed assets, profit on sale of

investments, excess provision return back, duty drawback and interest income could be said to have direct nexus with the income of the business of the undertaking. It further held that although such income may not partake the character of profit and gain from the sale of article, yet it could be termed as an income derived from the consideration realized by the export articles and held that in view of the definition of "income from profits and gains" incorporated in sub-section (4), the Tribunal committed no error in granting the benefit of exemption, as contemplated under Section 10B of the Act.

16.10 Therefore, in view of the above categorical views of the Hon'ble Courts that any profit of business earned by the unit which is eligible to deduction u/s 10A of the Act, would also include profit earned by the way of interest on fixed deposits from bank, investment from mutual funds and like other items provided it is earned out of the internal accruals of the unit eligible for deduction u/s 10A of the Act. However, the AO has to verify that the income arising out to the assessee in respect of interest on fixed deposits from bank, investment from mutual funds and like other items is out of the internal accrual of the funds of the assessee company before allowing the exemption claim by the assessee. The assessee is directed to submit the necessary claim in this regard and the AO is directed to consider it for deduction / exemption as per our above observations relying upon the decision of Hon'ble Delhi High Court in the case of CIT Vs. Riviera Home Furnishing vs ACIT (supra)

and the Hon'ble Gujarat High Court in the case of PCIT Vs. Dishman Pharmaceuticals & Chemical Ltd. (supra). The additional ground of appeal is allowed as above.

17. Ground no. 12 of the appeal is against the charges of interest u/s 234B, 234C and 234D of the Act. Charging of interest is consequential and mandatory in nature. The AO is directed to charge interest as per law which giving effect to this order.

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

ITA No.- 5465/Del/2011 for A.Y. 2007-08

19. The grounds of appeal and the facts of the case in A.Y. 2007-08 are identical to the grounds of appeal and the facts of the case for A.Y. 2006-07 in ITA No.- 5624/Del/2010 except for variation in the amounts. Therefore, our decision will apply *mutatis mutandis* in respect of the following grounds for A.Y. 2007-08 as per the details in the tabular chart below.

Sr. no.	Issue in brief	Filed on	Ground no. of appeal for A.Y. 2007-08 in ITA No. 5465/Del/2011	Ground no. of appeal for A.Y. 2006-07 in ITA No. 5624/Del/2011	Remarks
1.	General	10.12.2010/ 07.12.2011	Ground no. 1	Ground no. 1	<i>Mutatis mutandis</i>
2.	STPI 10A license claim	10.12.2010 07.12.2011	Ground no. 2 to 2.16	Ground no. 2 to 2.16	do
3.	60% of expenses on technical service	10.12.2010/ 07.12.2011	Ground no. 3 to 3.3	Ground no. 3 to 3.3	do

4.	60% of expenses on data link charges	10.12.2010/ 07.12.2011	Ground no. 4 to 4.2	Ground no. 4 to 4.2	do
5.	Losses of non STPI units	10.12.2010/ 07.12.2011	Ground no. 5 to 5.5	Ground no. 5 to 5.5	do
6.	Computer accessories depreciation @ 15% agreement 60% claimed by the assessee	10.12.2010/ 07.12.2011	Ground no. 6 to 6.1	Ground no. 6 to 6.2	do
7.	14A	10.12.2010/ 07.12.2011	Ground no. 7 to 7.2	Ground no. 7 to 7.2	do
8.	Deduction of profits DSL software ltd. u/s 10A of the Act	10.12.2010/ 07.12.2011	Ground no. 8 to 8.2	Ground no. 8 to 8.1	do
9.	ESOP expenses	10.12.2010/ 07.12.2011	Ground no. 9 to 9.2	Ground no. 9 to 9.1	do
10.	Disallowance of software license fees expense	10.12.2010/ 07.12.2011	Ground no. 10 to 10.3 AY. 2007-08	Ground no. 10 to 10.3 AY 2006-07	do
11.		10.12.2010/ 07.12.2011	Ground no. 11-11.1 Disallowance of expenditure toward premature / unwinding/ cancellation of forward courses.	Non allowance of Foreign Tax Credit (FTC)	Ground no. 11 in A.Y. 2006-07 has been separately discussed earlier in this order and ground no. 11 of the appeal for A.Y. 2007-08 is being discussed later in this order.
12.		10.12.2010/ 07.12.2011	Ground no. 12, addition on account of sundry creditors written back	Ground no. 12, 234B, 234C and 234D.	Ground no. 12 for A.Y. 2007-08 being dealt separately

					in this order
13.		10.12.2010/ 07.12.2011	Ground no. 13, 234B, 234C and 234D.	Ground no. 12, 234B, 234C and 234D.	Mutatis mutandis
14.	DDT	28.01.2019	Additional ground no. 1	Additional ground no. 1	<i>Mutatis mutandis</i>
15.	Education cess	15.07.2020	Additional ground no. 2	Additional ground no. 2	do
16.	Systematic activity enhanced deducted u/s 10A	28.01.2019	Additional ground no. 3	Additional ground no. 3	do
17.	Foreign tax credit	09.06.2016	Additional ground no. 4	Additional ground no. 4	do
18.	ESOP	28.06.2014	Additional ground no. 5	Additional ground no. 5	do

19.1 Ground of Appeal Nos.11 to 11.1: Disallowance of expenditure towards premature unwinding/cancellation of forward covers. The AO made a disallowance of Rs. 1,13,76,943/- being realized foreign exchange loss on pre-mature unwinding of the forward covers taken by the assessee.

19.2 The AO made the disallowance as under:

*“N. The issue of Allowability/Disallowability of foreign exchange gain/(loss) claimed by the assessee has been discussed in the draft assessment order as follows:-
29 Foreign exchange gain/ (loss). The assessee has shown a net income of Rs. 21.87 Crores on account of Exchange differences during the financial year under consideration The assessee was asked to furnish the details of the said foreign exchange gain of Rs. 21.87 Crores. In response to the said query, the assessee has explained that the said foreign exchange gain comprises of the following four (4) broad categories:-*

S.No.	Nature of Foreign Exchange Gain/(Loss)	Amount (in Crores of Rupees)
1.	Realized Foreign Exchange Loss	(51.90)
2.	Unrealized Foreign Exchange Loss on account of restatement of foreign currency denominated trade assets/liabilities	(6.15)
3.	Realized Foreign Exchange Loss on pre-mature unwinding of the forward covers taken by the assessee	(1.14)
4.	Unrealized Foreign Exchange Gain on account of Marked to Market ("MTM") restatement of forward covers outstanding as on 31/03/2007	81.06
TOTAL FOREIGN EXCHNAGE GAIN		21.87

As explained by the assessee, being engaged in the business of development and export of computer software/ITES, the assessee derives its revenues primarily from the exports and the export proceeds are received by the assessee in the foreign currencies only. For the financial year under consideration, the export turnover was accounting for almost 99% of the total revenue of the assessee.

The assessee was asked to explain as to why the forward covers were booked by the assessee. In response to the said query, the assessee had submitted that the assessee had taken the forward covers to hedge its export realizations as a part of hedging strategy to mitigate the risk of changes in foreign exchange rates associated with the foreign currency receivables and the said forward covers were utilized against the export realizations. It was also explained by the assessee that it had entered into forward contracts with the bankers for hedging the export realizations with an object of having a better visibility about the future revenue realizations for planning the enterprise resources in a more structured manner. The assessee had further explained that it is a common practice in the IT Industry to have recourse to the Hedging strategy as the assessee had done in view of highly volatile nature of the underlying foreign currencies in which the assessee had entered into the forward covers with its Bankers. The assessee had categorically submitted that all the forward covers which the assessee had booked were taken from its Bankers only against the future export realizations.

Regarding the foreign exchange loss of Rs. 1.14 Crores which the assessee had incurred on account of pre-mature utilization/cancellation of the forward covers, the assessee has submitted that the said aggregate amount of Rs. 1.14 Crores was comprising of the following three (3) categories:-

Category-1

Additional Charges paid by the Assessee Company to its Bankers on account of pre-mature utilization of the underlying forward covers which the Assessee Company had taken from its Bankers in the normal course of its business (Out of the above

referred aggregate amount of Rs. 1.14 Crores, an amount of Rs. 0.72 Crores was pertaining to this category).

Category-II

Amount which the Assessee Company had to pay to its Bankers on account of difference between the foreign exchange rate at which the underlying forward cover was booked by the Assessee Company and the prevailing exchange rate as on the date of actual realization of the hedged export proceeds because the underlying hedged export proceeds were received by the Assessee Company in its Bank Account with one Banker and the underlying forward cover was taken from other Banker.

Category-III

loss arising on account of pre-mature unwinding of the underlying forward covers occasioned by the short-term highly volatile nature of the foreign currencies to act as stop-loss mechanism for minimizing the genuine business losses associated with the fluctuation in the foreign exchange rates having its nexus with the realization of the export proceeds of the Assessee Company.

In support of foreign exchange loss arising on account of pre-mature cancellation of the forward covers, the assessee had explained that the decision taken by the assessee to unwind/cancel some of the short term forward covers was a part of proactive treasury policy of the assessee and it was some sort of stop loss mechanism which the assessee had resorted to for avoiding a highly uncertain situation wherein the assessee would have otherwise found itself. The assessee has also cited the decision of AAR in the case of Soprophsa SA.. In re cited in 268 ITR 37 (which contains the reference of CBDT Circular No. 23D dated 12/09/1960 which was issued in the context of Section 24(1) of the Income Tax Act, 1922) and judgement of Bombay High Court Commissioner Of Income-Tax vs Badridas Gauridu (P) Ltd 2003 261 ITR 256 (Bom) in support of its contention that all the underlying transactions of entering into the forward contracts with the Bankers and the subsequent utilization/pre-mature cancellation/unwinding of the underlying forward covers were carried out by the assessee in the normal course of its business only and the same were purely in the nature of hedging with no element whatsoever of speculation.

I have carefully considered the submissions of the assessee. I find a lot of merit in the contention of the assessee that the following two (2) categories are in the nature of Business Income:-

a) Realized Foreign Exchange Loss (Rs. 51.90 Crores);

b) Unrealized Foreign Exchange Loss (Rs. 6.15 Crores):

The first category of Realized foreign exchange gain/(loss) does not fall within the preview of section 43(5) of the Act having regard to the fact that the underlying

forward contracts were settled by the assessee by taking the actual delivery of the underlying foreign currencies against the export realizations. Accordingly no adverse inference is drawn in respect of the same

The second category of unrealized foreign exchange gain/(loss), being associated with foreign currency denominated trade assets/(liabilities) incurred by the assessee in the normal course of its business, also represents business profits/(loss) and as such no adverse inference is drawn in respect of the same.

However, I am not satisfied with the contention of the assessee that the foreign exchange loss of Rs. 1.14 Crores arising on account of pre-mature cancellation/unwinding of the forward covers is in the nature of business loss arising in the normal course of business carried out by the assessee, I am of the view that such loss arising because of cancellation/pre-mature unwinding of the forward covers is in the nature of speculative loss within the meaning of Section 43(5) of the Income Tax Act, 1961 to be read with CBDT instruction no. 3/2010 dated 23 March, 2010. The relevant provisions from Section 43(5) of the I.T.Act are being reproduced as under:-

"Section 43(5) of the Act defines "Speculative Transaction" as below:-

"speculative transaction" means a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips:

Provided that for the purposes of this clause-

(a) a contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchanting business to guard against loss through future price fluctuations in respect of his contracts for actual delivery of goods manufactured by him or merchandise sold by him, or

(b) a contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuations, or

(c) a contract entered into by a member of a forward market or a stock exchange in the course of any transaction in the nature of jobbing or arbitrage to guard against loss which may arise in the ordinary course of his business as such member or

(d) an eligible transaction in respect of trading in derivatives referred to in clause 30((ac)]30 of section 2 of the Securities Contracts (Regulation) Act. 1956(42 of 1956) carried out in recognized stock exchange.

shall not be deemed to be a speculative transaction.

Explanation:- For the purposes of this clause, the expressions--

(1) "eligible transaction" means any transaction,

(A) carried out electronically on screen-based systems through a stock broker or sub-broker or such other intermediary registered under section 12 of the Securities and Exchange Board of India Act, 1992(15 of 1992) in accordance with the provisions of the Securities Contracts (Regulation) Act, 1956(42 of 1956) or the Securities and Exchange Board of India Act, 1992 or the Depositories Act, 1996(22 of 1996) and the rules, regulations or bye-laws made or directions issued under those Acts or by banks or mutual funds on a recognized stock exchange, and

(B) which is supported by a time stamped contract note issued by such stock broker or sub-broker or such other intermediary to every client indicating in the contract note the unique client identity number allotted under any Act referred to in sub-clause (A) and permanent account number allotted under this Act,

(ii) "recognised stock exchange" means a recognized stock exchange as referred to in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956(42 of 1956) and which fulfils such conditions as may be prescribed and notified by the Central Government for this purpose.]

Since the instant case of the assessee is not covered by any of situations as envisaged by Clause (a) to (d) of Section 43(5) of the Act, accordingly, I do hereby disallow the foreign exchange loss of Rs. 1.14 Crores which the assessee had wrongly claimed as "Business Loss

The DRP-I has upheld the conclusion drawn by the AO in the following words:-

After examining the matter, the DRP is of the view that the action of the AO is correct. Foreign exchange loss arising on account of cancellation of the forward covers which were entered into by the company as a part of its hedging strategy of account of foreign exchange fluctuations are speculative. The AO has correctly analyzed that the assessee is not covered by any of the situations envisaged by Clause (a) to (d) of section 43(5) and therefore the AO has correctly made the disallowance."

In view of the decision of DRP the order made by the AO in the draft assessment order is finalized and Foreign exchange loss of Rs. 1.14 cr. is hereby disallowed.

Penalty proceedings u/s 271(1)(c) is separately being initiated for filing inaccurate particulars of income."

19.3 Aggrieved with the said order, the assessee filed an appeal before us, on the

following grounds of appeal:

“11. That the assessing officer erred on facts and in law in disallowing an amount of Rs. 1,13,76,943 in respect of pre-mature unwinding/cancellation of the forward covers taken by the appellant in the normal course of its business, purely as a part of its hedging strategy, by arbitrarily deeming it to be speculative in nature under the provisions of Section 43 (5) of the Act.

11.1. That the Hon'ble DRP erred on facts and in law in upholding the proposed action of the learned AO of disallowing the foreign exchange loss of Rs. 1,13,76,943 in respect of pre-mature unwinding/cancellation of the forward covers taken by the appellant.”

19.4 In support of the above grounds of appeal, the Sr. Counsel submitted as under:

“The Appellant is engaged in the business of development/provision of computer software/ ITES and derives revenue mainly from export thereof. Since, almost entire amount of export proceeds is received by Appellant in foreign currencies (which majorly include USD, GBP and Euro), the Appellant is exposed to foreign exchange loss arising on account of foreign currency fluctuations on foreign currency assets/ liabilities, forecasted export realizations denominated in foreign currencies. The Appellant follows a strategy of hedging foreign currency denominated export realizations by taking forward covers consistent with the Risk Management Policy of the Appellant. Since these forward covers are taken by Appellant from various banks, the counter party in these forward cover contracts is the Bank. Such forward covers taken by Appellant usually have a maturity period ranging from one month to twenty months to hedge the foreign exchange risk associated with the forecasted export realizations which are expected to be realized during the corresponding period. Such forward covers are not used by Appellant for speculative purposes.

The assessing officer disallowed the foreign exchange loss of Rs.1,13,76,943, which was claimed as business loss arising on account of cancellation/ premature unwinding up of the forward covers holding that the same was in the nature of speculative loss within the meaning of section 43(5) of the Act.

It is submitted that loss arising out of business activity is allowed as deduction provided the following conditions are satisfied:

- (i) The loss should be incidental to the carrying on of the business and should arise from or spring out of carrying on of business;*
- (ii) It should be a loss on revenue account and not on capital account.*

It is respectfully submitted that forward exchange contracts were booked by the Appellant in the normal course of business only and the loss arising on account of cancellation/ pre-mature unwind of the forward covers was incidental to the Appellant's regular course of business. Since the Appellant is engaged in the business of development of software only, the act of entering into the forward contracts by the Appellant with its bankers to hedge the future foreign currency fluctuation risk cannot be deemed to be a separate/ speculative business of the Appellant.

If the forward cover is unwound prior to the date of maturity in the anticipation of further future adverse foreign exchange movement and the forward cover was booked during the financial year under consideration, the foreign exchange gain/ loss arising between the date on which the forward cover was booked and the date of pre-mature unwinding of the forward cover is debited/ credited to the Profit & Loss account. However, if the forward cover was booked during the earlier financial years, it is only the foreign exchange gain/ loss arising between the date of last Balance Sheet and the date of pre-mature unwinding of the forward cover, which is debited/ credited to the Profit & Loss account. The exchange difference between the date on which the forward cover was booked and the date of last Balance Sheet is debited/ credited to the Profit & Loss account for the last financial year only.

It is respectfully pointed out that in terms of the Foreign Exchange Management Act and RBI Guidelines, a person resident in India can enter into derivative contracts in foreign currency, with an Authorized Dealer/ Bank in India, only to hedge the exposure of risk in foreign currency arising from a transaction of sale/ purchase in foreign currency.

The Appellant had, it is respectfully submitted, in accordance with the Guidelines issued by the RBI, booked the forward exchange contracts adhering to the sanctioned derivative limits.

It is pertinent to note that the derivative contracts entered into with the Authorized Banks may not necessarily be for the duration or mature on the dates on which the export proceeds are to be received. For example, based on forecasted exports, the Appellant takes contracts in April, which mature in September. There may be instances where the actual export contract receivables may fall due in the period post September and are not due till September.

It is for this reason that the purpose of entering into the derivative contracts is essentially to hedge the foreign exchange exposure to the extent of the aforesaid amount in respect of future exports.

In the aforesaid case, the Appellant may, at its discretion and in the interest of the business, either request for an early delivery, extension, or cancellation of the forward contract on or before the date of maturity. Banks, in such cases, recover the differential price between the contracted rate and the rate at which the early delivery/ extension/ cancellation is to be effected.

Kind attention in this regard is invited to Rule 6 of The Foreign Exchange Dealers' Association of India ("FEDAI") Rules which lay down the conditions, manner and mechanism for "Early Delivery, Extension and Cancellation of Forward Exchange Contracts". Relevant extracts of the said Rule are as under:

"RULE 6

EARLY DELIVERY, EXTENSION AND CANCELLATION OF FOREIGN EXCHANGE CONTRACTS

6.A-1 General

i. At the request of the customer, unless stated to the contrary in the provisions of FEMA, 1999, it is optional for a bank to :

a. Accept or give early delivery.

b. Extend the contract.

ii. It is the responsibility of the customer to effect delivery or to request the bank for extension/cancellation as the case may be on or before the maturity date of the contract.

.....

6.A-4 Cancellation

i. In the case of cancellation of a contract at the request of the customer (the request shall be made on or before the maturity date) the Authorised Dealer shall recover/pay, as the case may be, the difference between the contracted rate and the rate at which the cancellation is effected. The recovery/payment of exchange difference on cancellation of forward contracts before the maturity dates may be either upfront or back-ended in the discretion of banks.

ii. Rate at which cancellation is to be effected:

a. Purchase contracts shall be cancelled at the contracting Authorised Dealers spot T.T. selling rate current on the date of cancellation.

b. Sale contracts shall be cancelled at the contracting Authorised Dealers spot T.T. buying rate current on the date of cancellation.

c. Where the contract is cancelled before maturity, the appropriate forward T.T. rate shall be applied.

iii. Exchange difference not exceeding Rs. 100 shall be ignored by the contracting bank.

iv Notwithstanding the fact that the exchange contract between the customer and the bank becomes impossible of performance, for whatever reason, including Government prohibitory order, the exchange contract shall not be deemed to have become void and the customer shall forthwith apply to the

Authorised Dealer for cancellation subject to provisions of paragraphs 6.A.4.i to iii above.

v. a. In the absence of any instructions from the customer, vide para 6A..i contracts which have matured shall be automatically cancelled on the 15th day after maturity date. In case 15th day falls on a Saturday or holiday, the contract shall be cancelled on the next succeeding working day.

However the contract may also be cancelled after the maturity date but before the 15th day with specific understanding and written request from the customer.

b. Swap cost, if any, shall be recovered from the customer under advice to him.

c. When the contract is cancelled after the due date, the customer shall not be entitled to the exchange difference, if any, in his favour, since the contract is cancelled on account of his default, he shall, however, be liable to pay the exchange difference, against him.

In the circumstances, where the Appellant resorted to cancellation of forward contracts, in compliance with the aforesaid directions issued by FEDAI, the assessee paid the difference between the forward contract rate and the rate at which the cancellation was effected to/ from the banks. Such rate differential resulted in net loss of Rs.1.13 crores on the cancellation of the forward contracts.

Loss on premature unwinding/ cancellation of the forward contract not speculative

Attention is invited to the provisions of section 43(5) of the Act, which reads as under:

"(5) "speculative transaction" means a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips:

On perusal of the aforesaid, it will kindly be appreciated that in order to be a "speculative transaction" in terms of section 43(5) of the Act, there should be a contract for purchase or sale of commodity and such contract should be settled otherwise than by actual delivery for transfer of the commodity.

Foreign currency is not commodity - section 43(5) not applicable

It is respectfully submitted that the derivative transactions of the nature entered into by the assessee to hedge against the fluctuations in the foreign currency does not involve purchase or sale of any commodity

The term "commodity" has not been defined under the Act. The said term shall have to be, thus, given the meaning as understood in common parlance.

The term "commodity" has been defined by Black's Law Dictionary as under:

"Commodity" means tangible goods which are article of trade or commerce such as raw materials, etc."

The Forward Contracts (Regulation) Act, 1952("FRA) defines goods' as "every kind of movable property other than actionable claims, money and securities."

"Major law Lexicon" by Pramantha Aiyer (4th Edition) defines the term "commodity" as under:

"commodity has two meanings (one) in economics, it is any tangible goods that is traded and (two) it is raw materials and goods, especially such goods as cocoa, coffee, jute, potatoes, tea, etc. which may also be traded. Thus, in common parlance, the expression commodity means an article of trade or commerce which are tangible in nature. (emphasis supplied)

On perusal of the above dictionary meanings of the term "Commodity", it would kindly be appreciated that the said term refers to any tangible good(s)/article(s), which can be freely traded in the market.

Foreign currency, as such, it is respectfully submitted, is not a freely tradable commodity. In India, as per the RBI norms, only Authorized Dealers/ Banks are, it will be appreciated, allowed to trade in foreign currency. It is not at all permissible in India to even hold foreign currency above a prescribed limit, leave aside trading in the same. That being so, foreign currency is, in our respectful submission, not a tradable article and is subject to various rules and regulations of the RBI.

It is respectfully submitted that the assessee had entered into forward exchange derivative contracts with banks which unlike exchange traded derivative contracts, are contracts wherein the parties contracting have certain rights and obligations, which are determined on the happening or non-happening of certain events, like, the price movement of foreign currency, etc., and come to an end after the prescribed duration. Such derivative contracts cannot be bought and sold traded. In view of the aforesaid, it is our respectful submission, that such contract cannot be regarded as goods/ asset or "commodity". The rights under an OTC derivative contract cannot be equated with "commodity", more so when such rights cannot be transferred.

Reliance in this regard is placed on the decision of Madras High Court in the case of Shriram Transport Finance Company Limited vs ITO: TCA No.755 of 2009, wherein it has been held that since foreign currency is not covered under "commodity", the provisions of "speculative loss" as contained in Section 43(5) of the Act are not applicable in the case of losses arising from the forward covers taken by the assessee.

*Kind attention is invited to the decision of **Delhi Bench of the Tribunal** in the case of **Munjal Showa Ltd vs DCIT: 94 TTJ 227 (Del Trib.)**, wherein while examining the meaning of the word commodity", as used in section 43(5) of the*

*Act, the Court held that foreign currency cannot be regarded as *commodity for the purposes of the said section and, therefore, derivative/ forward contract in respect of the same cannot also be considered as "commodity" for purposes of the said section. The relevant observations of the Tribunal are as under:*

"31. Foreign currency or any currency is neither commodity nor shares. The Sale of Goods Act, specifically excludes cash from the definition of goods. Besides, no person other than authorised dealers and money changers are allowed in India to trade in foreign currency, much less speculate. Sec. 8 of the Foreign Exchange Regulations Act, 1973, provides that except with prior general or special permission of the RBI, no person other than an authorised dealer shall purchase, acquire, borrow or sell foreign currency.

32. In fact, prior to the LERMS, residents in India were not even permitted to cancel forward contracts. The presumption of any speculative transaction is, therefore, directly rebutted in view of the legal impossibility and in view of the fact that foreign currency was neither commodity nor shares.

*Furthermore, the Mumbai Bench of the Tribunal in the case of **ACT vs Hexaware Technologies Ltd: ITA No.4688/Mum/2013 (Mum Trib.)** held*

*"8. From the record we also found that the loss had arisen on cancellation of foreign currency derivative contracts which is legally permissible under FEMA. None of these acts were prohibited activities. The loss had arisen on cancellation of foreign currency contracts executed by the employee exceeding his authority/fiduciary powers and making use of forged Board Resolutions. Thus, we found that assessee company has not conducted any crime but has been a victim of misconduct of the employee in the course of his normal duties, therefore, the said loss is allowable u/s. 37(1). We also found that loss was not in the nature of speculative loss in so far as loss was not occasioned due to any purchase or sale of commodity, but a foreign currency which is not a commodity The CIT(A) has dealt with threadbare with each and every objection of the AO and after applying judicial pronouncements to the facts of instant case reached to the conclusion that loss was incurred in the normal course of assessee's business and the same was not in the nature of speculative loss. We also found that the contract entered by the employee was not settled but these were cancelled by the assessee company, therefore, not coming in the mischief of section 43(5) which covers a situation where contract is settled otherwise than by actual delivery/transfer. **Therefore, provisions of Section 43(5) of the Act should not apply to above loss which is incurred on cancellation of certain foreign exchange contracts.**"*

(emphasis supplied)

Similar view has been taken in the following cases:

- *ACIT vs Lifestyle International (P) Ltd: ITA No.2258/Bang/2016 (Bang Trib.)*
- *ACIT vs Gimpex (P) Ltd: [2023] 154 taxmann.com 398 (Chenn Trib.)*

In view of the aforesaid, it is respectfully submitted that the foreign currency forward contracts cannot be regarded as commodity" and, therefore, the ingredients required for a transaction to qualify as a speculative transaction' under section 43(5) of the Act are not satisfied. Consequently, the provisions of the said section are not applicable at all.

Business loss on account of hedging contracts - allowable as deduction

Without prejudice to the aforesaid, it is respectfully submitted that the Appellant had entered into the aforesaid foreign exchange derivative contracts as a hedge against the risk of weakening dollar to the rupee in relation to its estimated exports proceeds receivable in foreign currency. The said derivative contracts were not de hors or independent of the business of export carried on by the Appellant.

The aforesaid derivate contracts were genuine hedging contracts and were not entered into with the intention to speculate or deal in the same. The RBI, as stated earlier, does not allow a resident person to enter into such derivative contracts, unless the same is to hedge the foreign currency exposure arising in the normal course of business. If the contracts are not for such a purpose, the same are liable to be cancelled by RBI/ Banks/ Authorized Dealers.

It is respectfully submitted that the Authorized Dealers with whom the Appellant entered into derivative contracts would not have entered into such contracts, in the first place, had the same been for a purpose other than to hedge the foreign currency fluctuation risk in the normal course of business transactions of the Appellant. The Appellant had settled most of contracts at maturity only. There were only a few cases of premature cancellation of contracts, which were cancelled with a view to cut losses that would have arisen, if the contracts were to run their full course.

The aforesaid conduct of the Appellant, respectfully submitted, further leads to the irresistible conclusion that the derivative contracts were not entered for the purposes of speculation.

Reliance in this regard is placed on the following decisions wherein it has been held that where foreign exchange contracts were only incidental to the assessee's regular course of business, the loss arising on account of cancellation of forward exchange contracts was an allowable deduction and not speculative loss:

Emmsons International Ltd vs ACIT: [2020] 180 ITD 292 (Del Trib.); affirmed in PCIT vs Emmsons International Ltd: [2022] ITA 318/2022 (Del); Revenue's SLP dismissed in PCIT vs Emmsons International Ltd: SLP (Civil) Diary No.49827/2023 (SC)

- *Pankaj Oil Mills vs CIT: [1978] 115 ITR 824 (Guj)*
- *CIT vs Soorajmull Nagarmull: 129 ITR 169 (Cal)*
- *CIT vs Badridas Gauridu (P) Ltd: 261 ITR 256 (Bom)*

- *CIT vs Friends and Friends Shipping (P) Ltd: [2013] 217 Taxman 267 (Guj)*
- *CIT vs Panchmahal Steel Ltd: (2013] 215 Taxman 140 (Guj)*
- *CIT vs D Chetan & Co: [2017] 390 ITR 36 (Bom)*
- *DCIT vs Bank of Bahrain and Kuwait: 132 TTJ 505 (Mum) (SB)*
- *DCIT vs Intergold India Ltd: 27 SOT 239 (Mum Trib.)*
- *VST Industries Ltd vs ADIT (ITA No.647/Hyd/2012) (Hyd Trib.)*
- *Samsung India Electronics P Ltd vs ACIT: ITA No.5316/Del/2011 (Del Trib.)*
- *DCIT vs Bombay Diamond Co. Ltd: ITA No. 7488/Mum/07 (Mum Trib.)*
- *ACIT vs Sesa Goa Ltd: ITA No. 85/PNJ/2012 (Panaji)*
- *ACIT vs Balar Exports: ITA No. 2856/Ahd/2012 (Ahd)*
- *J.K. Techno Soft Ltd: ITA No.6160/Del/2016 (Del Trib.)*

In view of the aforesaid settled legal position, loss arising on trading account transactions due to exchange rate fluctuation is, in our respectful submission, allowable as business deduction. Further, as laid down in the aforesaid decisions, the increase/ decrease in liability due to exchange fluctuation has to be recognized in the year in which such increase/ decrease takes place and such gain/ loss would be taxable/ allowable in that year itself, irrespective of the fact that there is no actual settlement of the liability.

In that view of the matter, it is respectfully submitted that loss of Rs.1.13 crores debited by the Appellant in its profit and loss account is allowable business deduction/ business loss under sections 28/ 37(1) of the Act. ”

19.5 In reply, the Special Counsel filed a written submission as under:

“ 1. The Assessee is engaged in the business of developing and exporting computer software/ITES. It is an admitted fact that the Assessee primarily generates revenue from exports, with approximately 99% of its total revenue during the financial year under consideration stemming from export activities, and consequently, export proceeds are received in foreign currencies.

2. For the year under consideration, the Assessee reported a substantial net income of 21.87 Crores arising from exchange differences. When queried regarding the booking of forward covers, the Assessee broadly submitted that these were entered into with bankers to "hedge" export realizations. The stated purpose was to "mitigate the risk of changes in foreign exchange rates associated with foreign currency

receivables and to achieve "better visibility about future revenue realizations for planning purposes. The Assessee characterized this as a "common practice in the IT Industry given the highly volatile nature of the underlying foreign currencies" It was stated that all booked forward covers were taken from its bankers against the future export realizations"

3. It is submitted that the central to the present dispute is a claimed forex loss of ₹1.14 Crores which the Assessee states was incurred on account of "pre-mature utilization /cancellation of the forward covers" The Assessee has categorized this aggregate loss amount into three segments.

4. The critical third category of loss, pertinent to the disallowance, is described by the Assessee as arising from the pre-mature unwinding of the underlying forward covers." The Assessee's explanation for this specific loss is that it was "occasioned by the short term highly volatile nature of the foreign currencies to act as stop loss mechanism for minimizing the genuine business losses associated with the fluctuation in the foreign exchange rates having its nexus with the realization of the export proceeds of the Assessee Company."

5. During the course of assessment, disallowed the foreign exchange loss of 1,13,76,943.00 claimed by the Assessee, which was upheld by the Hon'ble DRP.

6. In this regard, it is submitted that the AO has correctly disallowed the foreign exchange loss of ₹1,13,76,943.00 claimed by the Assessee. This purported "business loss, arising from the pre-mature unwinding of underlying forward covers, was precisely characterized by the AO as speculative in nature within the meaning of Section 43(5) of the Act.

7. A perusal of the assessment order shows that the Assessee's own explanation for the "pre-mature unwinding pointed towards decisions made in response to "short term highly volatile nature of the foreign currencies and for implementing a "stop loss mechanism. The reason for this characterization has been explained by the Assessee as part of proactive treasury policy. While no explanation has been offered either before the AO or DRP or even before the Hon'ble Tribunal as to what constituted the said proactive treasury policy, it is suggestive that these specific actions were driven by active management decisions aimed at limiting losses on the derivative instruments themselves in a volatile market, rather than being a direct and necessary consequence of a completed underlying export transaction. The onus lies squarely on the Assessee to meticulously demonstrate the precise, unavoidable, and non-speculative nexus of each instance of "pre-mature unwinding with a specific and completed underlying export realization, particularly when the stated rationale involves 'stop-loss' measures influenced by 'short-term volatility of the currency market.

8. The Hon'ble Chennai ITAT's observation in Dy. CIT v. Asvini Fisheries (P.) Ltd. (ITA No. 2246/Mds/09), and subsequently relied upon in Cotton Blossom India (P.) Ltd. vs. Joint Commissioner of Income-tax, Tirupur (2016) 68 taxmann.com 38

*(Chennai-Trib), affirms the Revenue's position regarding premature cancellations
The Tribunal explicitly mandated that:*

"6. the Assessing Officer has to see whether there is any premature cancellation of forward contract of foreign exchange and that transaction should be taken out for the purpose of considering the business loss and only the transactions which are completed to be considered for the purpose of determining the business loss from these foreign exchange forward contract With this observation, we remand this issue to the file of the Assessing Officer for fresh consideration."

9. This directive clearly distinguishes between losses from completed, genuine hedging transactions and those arising from premature cancellations. The very act of pre-mature unwinding" ostensibly occasioned by the short term highly volatile nature of the foreign currencies and described as a "stop loss mechanism," deviates from a pure hedging transaction tied directly to export realization. Such decisions, made in response to market volatility and aimed at limiting losses on the derivative itself, invariably assume a speculative character, as they are not solely and directly linked to the underlying business exposure upon its completion.

10. The Hon'ble Mumbai ITAT's judgment in Araska Diamond (P.) Ltd. vs. ACIT [2014] 52 taxmann.com 238 (Mumbai) squarely places the onus on the Assessee to demonstrate that transactions are not speculative. As observed by the Tribunal:

"We find that in the case under consideration assessee was not dealing in Foreign Exchange, therefore transactions entered into by it in Foreign Exchange cannot be held to be hedging transactions. As the assessee is dealing in diamonds and FC entered into only for diamonds would have been covered by the proviso (a) to the section 43(5) of the Act. As held by the Hon'ble High Court of Calcutta in the matter of CIT v. Gourepore Co. Ltd. [1982] 135 ITR 606/8 Taxman 94 (Cal), onus was on the assessee to prove that the transactions in question were not of a speculative nature: We are of the opinion that it has failed to discharge the onus cast upon him by the statute. It was also not able to contradict the finding of fact that booking and cancellation of FC of foreign exchange were not in respect of specified export or import. Besides, finding of fact given by the Revenue Authorities remained uncontravened that loss in question, shown by it pertained to those FC transactions, against which no actual delivery of foreign exchange was made"

11. In the present case, the Assessee bears the burden to conclusively prove that the pre-mature unwinding of forward covers was not speculative. The assertion that

these actions were merely a "stop loss mechanism for minimizing genuine business losses associated with the fluctuation in the foreign exchange rates" does not automatically transform a derivative transaction from a speculative nature into a genuine business loss, especially when the underlying export proceeds were not yet realized or settled against that specific cover. The Assessee has failed to provide sufficient evidence to discharge this statutory onus.

CONCLUSION

12. Therefore, based on the unambiguous legal precedents and the specific nature of the transactions involving premature cancellation/unwinding of foreign exchange forward contracts, it is unequivocally submitted that such losses cannot be legitimately included in the determination of business loss. These transactions, driven by short-term market volatility and aiming at a "stop loss," inherently fall within the purview of speculative transactions as defined by Section 43(5) of the Act. The AO's disallowance is entirely justified and must be upheld."

19.6 In rejoinder, the assessee submitted as under:

78. *"The Revenue alleged that cancellation of forward covers being an act of "pre-mature unwinding" ostensibly "occasioned by the short term highly volatile nature of the foreign currencies" and described as a "stop loss mechanism," deviates from a pure hedging transaction tied directly to export realization. It has accordingly been contended by the Revenue that such loss on account of premature unwinding/cancellation of forward covers is speculative in nature within the meaning of 43(5) of the Act.*

79. *The aforesaid contention, it is submitted, is contrary to the facts of the case, statutory provisions and well-settled judicial precedents, as explained hereunder:*

80. *The Appellant, it is submitted, is engaged in the business of development/ provision of computer software/ ITES and derives revenue mainly from export thereof. Since, almost entire amount of export proceeds are received by the Appellant in foreign currencies (which majorly include USD, GBP and Euro) whereas a substantial portion of its expenditure is denominated in INR being the functional currency, the Appellant is exposed to foreign exchange risk arising on account of foreign*

currency fluctuations on foreign currency assets/ liabilities, forecasted export realizations denominated in foreign currencies.

81. *Furthermore, it is submitted that it is common practice in Export/ IT industry to hedge future forecasted revenue over a period which may stretch from 1 to 5 years. Further, the future forecasted revenue inflows are supported by existing multi-year customer contracts or future revenue estimates. The hedging of forecasted export revenue is specifically permitted by RBI under its currency risk management framework. It is submitted that all forward contracts are made strictly as per the guidelines issued by RBI wherein it is, inter alia, required to mention the underlying exposure intended to be hedged, which in the present case is future export revenues. As a Board mandated policy, the Appellant neither speculates in foreign currency nor is it permitted to do so by the RBI.*

82. *As per the RBI regulations, the bank fixes the hedging limit for the exporter at the beginning of the year, which is then utilized by the exporter throughout the year. All hedging contracts are executed (or unwinded) through authorized banks designated by RBI for the taxpayer, duly certified to be strictly in accordance with the RBI regulations by a chartered accountant. As it can be observed from the below table, the forward covers held by the Appellant has always been within the hedging limits prescribed by RBI:*

Year ending	Avg FX rate	Closing balance of Forward covers held by Appellant	Closing Debtor Balance	Cummulative Revenue (CY+2)	Total Exposure	Forward Covers as a % of Total Exposure
		(A)	(B1)	(B2)	(B = B1+B2)	(A)/(B)
Mar-06	44.28	2,472	501	10,479	10,979	23%
Mar-07	45.29	3,936	721	12,609	13,330	30%
Mar-08	40.24	10,846	905	13,810	14,715	74%

83. *Also, the statutory auditors of the Appellant do the review of the Appellant's hedge books every year/ quarter to ensure hedge effectiveness, its compliance with Board mandated risk management hedging policy and RBI guidelines. Samples copies of the relevant documents, maintained by the Appellant and shared with the statutory*

auditors, are enclosed at **pages 1-5 of the Rejoinder Paper Book**. A perusal of the documents would reveal that the sole objective of taking forward cover is to reduce the variability in the INR-equivalent cash flows expected to be received on the forecasted foreign currency-denominated sales by the Company.

84. Further, the forward contract document issued by the concerned AD banks also categorically state that the purpose of buying the forward contract is for hedging receivables rather than for speculation. Copy of FX Forward Transaction Confirmation entered into between the Appellant and Barclays Bank PLC is enclosed at **pages 6-13 of the Rejoinder Paper Book**.
85. To note, the Company risk management policy strictly prohibits engaging in speculative currency hedging transactions. This is categorically stated in the Management Discussion section of the published Annual Report of the Appellant for financial years 2006-07, relevant to the subject assessment year; relevant extracts from the Annual Reports are reproduced hereunder:

“Page 5 of Annual Report

”Your Company actively books foreign exchange forward covers to hedge completely against foreign currency fluctuations related to its billed receivable and anticipated from projected revenues. The Company does not speculate in foreign currency.”

86. Further, the statutory auditors of the Appellant do the review of the Appellant's hedge books every year/ quarter to ensure compliance with Board mandated risk management hedging policy/ RBI guidance. It is also confirmed by the statutory auditors in the audited financial statements that the Appellant has taken forward covers only to hedge foreign exchange denominated receivables and forecasted foreign exchange earnings. Relevant extracts are reproduced hereunder:

“Page 50 of Annual Report

(j) **Forward exchange contracts and options**

The Company purchases foreign exchange forward contracts and options to mitigate the risk of changes in foreign exchange rates associated with receivables and forecasted cash flows denominated in foreign currencies.

For forward contracts associated with forecasted transactions, gains or losses arising due to change in fair value of the forward contract has been recognized in the Profit and Loss account.

For forward contracts associated with underlying outstandings at the Balance Sheet date, the exchange difference on such contracts are recognized in the Profit and Loss account in the reporting period in which exchange rates changes. The premium or discount on all such contracts arising at the inception are amortised as in income or expense over the life of the contract.

”

87. *The Appellant follows a strategy of hedging foreign currency denominated forecasted export realizations by taking forward covers consistent with the Risk Management Policy of the Appellant to safeguard against volatility in cash inflow due to currency fluctuation, which may have significant impact on its operating margins, ability to be price competitive in the market and even viability to sustain its business model in long term. These forward covers are taken by the Appellant from various banks, which are the counter party in these forward cover contracts by Appellant usually of a maturity period ranging from 1 month to 20 months to hedge the foreign exchange risk associated with the forecasted export realizations, which are expected to be realized during the corresponding period.*
88. *It is submitted that the period from financial year 2006-07 to 2009-10 was marked by significant turmoil in the world economy and global markets. To safeguard the operating margins and revenue, the Appellant decided to hedge estimated revenue for a longer duration, as permitted by RBI.*
89. *The turmoil in the world economy significantly impacted the Global IT industry including in India, which had strong trade links with the US and other affected economies. The crisis led to reduced IT spending, project cancellations, and job losses with significant downgrade of projected IT industry revenue from US clients. It is submitted that due to significant and sudden change in revenue growth projections, the Appellant, unexpectedly, found itself with excessive hedge*

positions, which had to be cancelled to meet the company's risk management policy. Also, based on the advice received from its bankers and as per its stop loss policy of a prudent businessman, it decided to reduce the period of hedging for the forecasted revenue leading to the cancellation of forward covers.

90. *It is submitted that the decision for pre-mature cancellation was driven purely by the Appellant's risk management hedging policy, stop loss policy and external demand factors impacting the future revenue growth of the Appellant, with no element of speculation, as also confirmed by the statutory auditors of the Appellant in the audited financial statements.*
91. *In finance, "hedging" is a risk management technique designed to minimize and eliminate the risk of uncertainty or eliminate financial risk and minimize loss; taking two positions that will offset each other if prices change, eg. the purchase of one asset with the intention of reducing the risk of loss from another asset. The Ld. Special Counsel of the Department, it is respectfully submitted, arbitrarily sought to misinterpret the prudent act of the Appellant of "pre-mature unwinding" of hedging contracts of the future export revenues, made in terms of the RBI regulated limits in the course of its business of export of softwares. Such hedging contracts admittedly tied directly to export realization are undertaken to minimize and eliminate the risk of uncertainty of a loss or liability on account of the short term highly volatile nature of the foreign currencies. It is submitted therefore, the "pre-mature unwinding" of hedging contracts for avoiding any loss (as stop loss), too, cannot be termed as deviating from a pure hedging transaction tied directly to export realization.*
92. ***Even otherwise***, expenditure incurred towards premature unwinding/ cancellation of forward covers cannot be said to be speculative in nature. It is submitted that section 43(5) of the Act provides that in order to be a speculative transaction, there should be a contract for purchase or sale of 'commodity' and such contract should be settled otherwise than by actual delivery for transfer of the commodity.

93. *It is submitted that the term 'commodity' refers to any tangible good(s)/ article(s), which can be freely traded in the market. Foreign currency, as such, it is respectfully submitted, is not a freely tradable commodity. In India, as per the RBI norms, only Authorized Dealers/ Banks are, it will be appreciated, allowed to trade in foreign currency. It is not at all permissible in India to even hold foreign currency above a prescribed limit, leave aside trading in the same. That being so, foreign currency is, in our respectful submission, not a tradable article and is subject to various rules and regulations of the RBI.*
94. *It is undisputed fact that the Appellant entered into foreign exchange derivative contracts with banks, which unlike exchange traded derivative contracts, are contracts wherein the parties contracting have certain rights and obligations, which are determined on the happening or non-happening of certain events, like, the price movement of foreign currency, etc., and come to an end after the prescribed duration. Such derivative contracts cannot be bought and sold/ traded. In view of the aforesaid, it is our respectful submission that such contracts cannot be regarded as 'goods/ asset' or 'commodity'. The rights under an over-the-counter derivative contract cannot be equated with 'commodity', more so when such rights cannot be transferred.*
95. *Reliance in this regard is placed on the following decisions wherein on identical facts, various High Courts have allowed deduction of loss on account of cancellation of forward contracts, holding the same to not fall within the ambit of 'speculative transaction' under section 43(5) of the Act:*
96. *In the case of **CIT vs Badridas Gauridu (P) Ltd [2003] 261 ITR 256 (Bom)** , the Bombay High Court allowed claim of business loss made by the assessee on account of cancellation of forward booking of foreign exchange with banks in respect of export orders. It was held that under section 43(5) of the Act, speculative transaction has been defined to mean a transaction in which a contract for the purchase or sale of commodity is settled otherwise than by the actual delivery or transfer of such commodity whereas in the said case, the assessee was not a dealer*

in foreign exchange and therefore, the transaction could not be said to be speculative in nature. [Refer pages 682-684 of Case Laws Paper Book]

97. Similarly, in **CIT vs Panchmahal Steel Ltd [2013] 215 Taxman 140 (Guj)**, the Gujarat High Court held that the Revenue authorities erred in rejecting the claim of loss incurred by the assessee on account of cancellation of forward contracts. It was held that such transaction would not fall within the ambit of 'speculative transaction' under section 43(5) of the Act.
98. The Madras High Court in **CIT vs Celebrity Fashion Ltd [2020] 428 ITR 470 (Mad)** held that loss incurred on account of cancellation of forward contracts would not be speculative loss falling within provisions of section 43(5) and that the assessee would be entitled to claim deduction in respect of such loss suffered by it as business loss.
99. Reliance in this regard is placed on the decision of the **Madras High Court** in the case of **Shriram Transport Finance Company Limited vs ITO in TCA No.755/2009**, wherein it was held that since foreign currency is not covered under "commodity", the provisions of "speculative loss" as contained in section 43(5) of the Act are not applicable in the case of losses arising from the forward covers taken by the assessee.
100. Reliance is further placed on the decision of this Hon'ble Tribunal in the case of **Munjal Showa Ltd vs DCIT 94 TTJ 227 (Del Trib.)**, wherein while examining the meaning of the word 'commodity' as used in section 43(5) of the Act, it was held that foreign currency cannot be regarded as 'commodity' for the purposes of the said section and therefore, derivative/ forward contract in respect of the same cannot also be considered as 'commodity' for purposes of the said section.
101. Similar view has been taken in the following cases:
- **ACIT vs Hexaware Technologies Ltd: ITA No.4688/Mum/2013 (Mum Trib)**
 - **ACIT vs Lifestyle International (P) Ltd: ITA No.2258/Bang/2016 (Bang Trib)**

- *ACIT vs Gimpex (P) Ltd: [2023] 154 taxmann.com 398 (Chenn Trib)*

102. *In view of the aforesaid, it is respectfully submitted that the foreign currency forward contracts cannot be regarded as 'commodity' and, therefore, the ingredients required for a transaction to qualify as 'speculative transaction' under section 43(5) of the Act are not satisfied. Consequently, the provisions of the said section are not applicable at all.*

Cases relied upon by the Revenue are wholly inapplicable

103. *Revenue's reliance on the decision of the Chennai bench of the Tribunal in **Asvini Fisheries (P) Ltd** (ITA No.2246/Mad/2009) and **Cotton Blossom India (P) Ltd** [2016] 68 taxmann.com 38 (Chennai Trib.) is misplaced and does not have bearing on the facts of the present case, which are squarely covered by the decisions cited above by the Appellant.*

104. *In the case of **Dy CIT vs Asvini Fisheries (P) Ltd (supra)**, only the amount of loss suffered in respect of cancellation of forward cover taken in excess of export turnover was held to be disallowable as speculative loss on the ground that the excess derivative transaction has no proximity with export turnover. In the present case, however, the Appellant has only hedged 30% of its forecasted export turnover; there are no forward covers taken in excess of the foreign currency receivables or forecasted export revenue. On the contrary, the taxpayer proactively took steps to reduce its hedge books to bring it in line with the business projection in the wake of volatile economic environment. Therefore, the said decision relied upon by the Revenue is not applicable.*

105. *Similarly, decision of the Mumbai bench of the Tribunal in **Araska Diamond (P) Ltd** [2014] 52 taxmann.com 238 (Mumbai Trib.) is of no relevance and is completely distinguishable on facts. In the said case, it was finding of fact that booking and cancellation of forward contracts of foreign exchange were not in respect of specified export or import of diamonds. It was noted that loss in question*

pertained to those forward contract transactions, against which no actual delivery of foreign exchange was made. Further, in the above case, out of contracts of US \$ 70,50,000, transactions worth US \$ 64,45,623 (i.e., almost 92%) were cancelled. The transactions were, therefore, held to be purely speculative in nature and not hedging transaction as the assessee could not relate any single bill to any of the forward contract. In the case of the Appellant, there is no such allegation that the forward covers taken by the Appellant were not linked to the foreign currency/export realizations. Also, in the case of the Appellant, the forward contracts cancelled were only a very insignificant portion of the total forward contracts. Thus, reliance placed by the Revenue on this decision is grossly misplaced.

106. *In that view of the matter, the Appellant submits that the decisions of benches of the Hon'ble Tribunal relied upon by the Revenue, being completely distinguishable on facts, are not relevant for deciding the issue arising in the present appeal. Moreover, the case of the Appellant is squarely covered by judgments rendered by various High Courts and this Hon'ble Tribunal, as referred to supra.*

107. *In light of the aforesaid, the Appellant respectfully submits that the loss incurred on cancellation of forward contracts is an allowable revenue deduction and disallowance made in this respect is uncalled for and deserves to be deleted."*

19.7 We have heard both the parties and perused the material available on record. The assessee has claimed the loss of Rs. 1,13,76,943/- being realized foreign exchange loss on pre-mature unwinding of the forward covers taken by the assessee. The AO disallowed this loss by treating it a speculative loss as it was not covered by any exception provided by clause (a) to (d) of section 43 (5) of the Act. On the other hand, the assessee submits, firstly, that foreign exchange is not a commodity

within the meaning of section 43 (5) of the Act it being a restrictive commodity, whereas, the commodity under section 43 (5) of the Act should be a freely trading commodity. In its support, the assessee has relied upon various case laws. Further, the senior counsel also referred to company's policy relying upon from the extract of its company's annual report that the company does not speculate in foreign currency. Further, it was submitted that the statutory auditors of the assessee do the review of the assessee's hedge books every year/ quarter to ensure compliance with Board mandated risk management hedging policy/ RBI guidance. It was further submitted that it was also confirmed by the statutory auditors in the audited financial statements that the assessee has taken forward covers only to hedge foreign exchange denominated receivables and forecasted foreign exchange earnings. On the other hand, the special counsel for the Revenue also relied upon various case laws in support of action of the A.O. However, the undisputed facts in this case are that the assessee's entire business is of export of software and for the financial year under consideration the export turnover was accounting for almost 99% of the total revenue of the assessee. Further, it is also an accepted fact that the loss of Rs. 1,13,76,943/- being realized foreign exchange loss on pre-mature unwinding of the forward covers taken by the assessee was to cover for the anticipated gain / loss in dollar rates for its export earnings. On similar facts, the Hon'ble Delhi High Court in the case of PCIT Vs. Simon India Ltd. (supra) held that the said transactions were

to hedge against the risk of foreign exchange fluctuations and thus, fall within the exceptions of proviso (a) to section 43(5) of the Act. The relevant extract of the said order is reproduced as below:

“23. Zoheb Hossain, learned counsel appearing for the Revenue, submitted that the loss on Forward Contracts was booked on a 'Marked to Market' basis and therefore was merely a notional loss in the relevant assessment year. And, it was not permissible for the Assessee to book such notional loss.

24. It is material to note that the only specific ground, stated by the Revenue in its appeal in respect of the deletion of loss on Forward Contracts, reads as under:

“(C) Because the losses on account of foreign exchange fluctuations on forward contracts are not allowable under section 37(1) of the Income-tax Act and covered as hedging transactions under section 43(5)(a) of the Act or should be disallowed as speculation losses under section 43(5) of the Act in view of the CBDT Instruction No. 3/2010 dated 23-3-2010.”

25. Thus, according to the Revenue, the learned CIT(A) and the learned Tribunal had erred in finding that the transaction under section 43(5)(a) of the Act. The Revenue contends that the said loss is required to be loss on account of Forward Contracts is allowable under section 37(1) of the Act and is covered as a hedging disallowed as a speculative loss in terms of the CBDT Instruction no. 3/2010.

26. The Revenue's contention is unmerited. There is no dispute that the Forward Contracts were entered into by the Assessee to hedge against foreign exchange fluctuations resulting from inflows/outflows in respect of the underlying contracts for provisions of consultancy and project management, Concededly, the Assessee is not dealing in foreign exchange. Clearly, the said transactions were to hedge against the risk of foreign exchange fluctuations and thus, fall within the exceptions of proviso (a) to section 43(5) of the Act. The exchange fluctuations in inflows and outflows relating to contracts for execution of the works entered into by the Assessee.

27. It is material to note that there is no allegation that the Assessee has not been following the system of AS-11. In terms of AS-11, the exchange difference arising on foreign currency transactions are necessary vi accounting consistently. In Woodward Governor India (P) Lid (supra), the Supreme Court had referred be recognized as income or expense in the period in which they arise, except in cases of exchange differences arising on repayment of liabilities for acquiring fixed assets.

28. In the present case, the Assessee had stated that it was reinstating its debtors and creditors in connection with execution of contracts entered into with foreign entities on the basis of the value of the foreign exchange require to be recognized as well.

29. *It is also relevant to refer to the findings of the learned CIT(A) in this regard. Paragraph no. 13 of the appellate order reads as under:*

13. It may be noted that the valuation-loss is reflected on the debit side of the P&L account whereas the corresponding valuation Gains resulting on the valuation of the debtors is reflected on the credit side included as part of sales/exchange Gains and in respect of imports as reduction in the import price on the debit of the Profit & Loss account. In other words, the entire transaction of either realization of debtors in foreign exchange/payment for imports in foreign exchange which are designated in foreign currency and the entering into Forward cover contract are integral part of the same transaction i.e. two sides of the same coin. By considering both sides of the P&L the correct net profit is worked out. Therefore, in order to ascertain the correct taxable profits of the appellant the loss has to be allowed as a business loss because it is due to the business exigency the forward contracts are entered into to protect against any loss that might result due to foreign exchange currency fluctuation foreign currency fluctuation."

30. Undisputedly, the Forward Contracts, in the present case, are hedging transactions. The Assessee has reinstated its debits and credits from the underlying transactions on the value of the foreign exchange on the due date. The corresponding losses/gains under the Forward Contracts, thus, were also required to be accounted for to arrive at the real profits. It would be anomalous if, on the one hand, debtors and creditors, in respect of current assets, are stated at the current value of foreign exchange and the corresponding loss on the hedging transaction is not accounted for. In essence, the Assessee has stated his income by taking into account the foreign exchange value as it stands on the due date. It is well settled that the CBDT Instructions and circulars which are contrary to law are not binding.

31. This Court finds no fault with the order of the learned CIT(A) as well as the learned Tribunal in finding that the loss, on account of Forward Contracts, cannot be considered as speculative and the AO had erred in disallowing the same. The questions raised (Questions I and II) are thus, covered by the decision of the Supreme Court in Woodward Governor India (P.) Ltd. (supra).

No substantial question of law arises from the ITA 976/Del/2013."

19.8 Respectfully following the same, we hold that the transaction in consideration fall within the exception of proviso (a) section 43(5) of the Act as it was to hedge against the risk of foreign exchange fluctuations in respects of its

export realization of its software licenses. Accordingly, we allow the claim of loss of Rs. 1,13,76,943/- is allowed. Ground no. 11 and 11.1 of the appeal is allowed.

20. Ground no. 12 of the appeal is against the addition of Rs. 60,80,534/- on account of static creditors written-back.

20.1 The AO made the addition as under:

“o. The issue of income arising out of the balances of sundry creditors outstanding for more than three years as on March 31, 2007 has been discussed in the draft assessment order as follows:-.

30 Sundry Creditors outstanding for more than three years as on March 31, 2007:

The assessee was asked to furnish the details of the sundry creditors which were outstanding for more than three years as at the end of the relevant financial year ended on March 31, 2007 In response to the said query, the assessee furnished the necessary party-wise details of sundry creditors which were outstanding for more than three years as on March 31 2007. As per the details filed by the assessee, the aggregate amount outstanding for more than three years stood at Rs. 60.80.534/-

The assessee was also asked to explain as to why the aforesaid aggregate amount of Rs 60.80.534/- should not be treated as business income arising out of cessation or remission of the trade liabilities represented by these sundry creditors which are outstanding for more than three years as at the end of the relevant financial year by invoking the provision of section 41 of the Income Tax Act. 1961 In response to the said query, the assessee has explained that these outstanding balances cannot be deemed to be an income having regard to the fact that the concerned parties have all the legal right to ask the assessee company to pay the same and the only reason for these balances lying outstanding for more than three years is the pending reconciliation of the outstanding balances in view of thousands of no. of the vendors of the assessee company The assessee has further submitted that if these outstanding balances turn out to be non payable at any time in future, the auditors of the assessee company shall report the same in the Tax Audit Report for the relevant assessment year. I don't find any merit in the contention of the assessee having regard to the fact that since there has been no movement in these outstanding balances for the last three years, it can safely be presumed that the income has already arisen to the assessee company under section 11 of the Income Tax Act. 1961 in view of remission/cessation of the underline trade liabilities incurred by the assessee

The DRP-I has upheld the action of the AO. The operative portion of the DRP order is quoted below:-

"It is seen that the said sundry creditors balances are lying dormant for more than 3 years. Normally under the limitation act, a time period of 2 years is given to make a claim. Therefore the assessee would be legally entitled to write off the outstanding in the accounts. In the instant case, it is seen that it has not done so and therefore the action of the AO is upheld."

In view of the decision of the DRP-I the addition of Rs. 60.80 lacs relating to remission of sundry creditors balances, made by the AO in the draft assessment order is hereby finalized.....

20.2 Aggrieved with the said order, the assessee filed an appeal before us on the following grounds of appeal:

" 12. That the assessing officer erred on facts and in law in making an addition of RS. 60,80,534 of Sundry Creditors balances outstanding for past three years by arbitrarily holding that the same was in the nature of income arising on remission/cessation of trade liability in the terms of Section 41 of the Act

12.1. That That the Hon'ble DRP erred on facts and in law in upholding the addition of Rs.60,80,534 of Sundry Creditors' balances outstanding for past three years.

20.3 The Sr. Counsel during the course of hearing filed a written submission which is reproduced as under:

"In the assessment order, addition of Rs.60,80,534 has been made, being credit balances of the creditors, which were allegedly static over past three years.

The assessing officer made the aforesaid addition holding the credit balances to be income of the Appellant allegedly on the ground that the liabilities in respect of same were no longer enforceable.

Reliance in this regard is placed on the following decisions of the jurisdictional Delhi High Court, wherein, it is held that outstanding liability, unless written-back, cannot be treated as income under section 41(1) of the Act on the ground that the same has become barred by limitation:

- *CIT vs Hotline Electronics Ltd: 205 Taxman 245 (Del)*
- *CIT vs Shri Vardhman Overseas Ltd: 343 ITR 408 (Del)*
- *PCIT vs Soorajmul Nagarmull: [2022] 145 taxmann.com 245 (Cal)*
- *PCIT vs Eco Auto Components (P) Ltd: [2018] 409 ITR 202 (P&H)*

The DRP/ AO have not considered the aforesaid binding judgments of the High Courts, including the jurisdictional Delhi High Court and accordingly, the disallowance made on this account deserves to be deleted.

20.4 In reply, the Special Counsel for Revenue submitted as under:

" 1. During the course of assessment proceedings, the AO initiated an inquiry by requesting the Assessee to provide comprehensive details of sundry creditors that had remained outstanding for a period exceeding three years as of the financial year-end. In response, the Assessee furnished party-wise particulars, confirming an aggregate outstanding amount of ₹60,80,534/- pertaining to such long-standing liabilities.

2. Following the disclosure of these outstanding balances, the AO issued a specific query requiring the Assessee to demonstrate why the aforementioned aggregate amount of ₹60,80,534/- should not be treated as business income. This proposed addition was squarely based on the premise that these liabilities represented a cessation or remission of trade liabilities, thereby attracting the provisions of Section 41(1) of the Act. In its response to the invocation of Section 41(1), the Assessee advanced the following arguments:-

i. It was broadly asserted that these outstanding balances "cannot be deemed to be an income as the "concerned parties have all the legal right to ask the assessee company to pay the same." This contention was presented without specific evidence of active demands or acknowledgements of debt from the creditors for the prolonged period.

ii. The primary reason cited for these balances remaining outstanding for over three years was attributed to "pending reconciliation of the outstanding balances in the vendors of the assessee company. No definitive timeline for this reconciliation was provided, nor were concrete steps outlined to resolve these long-pending discrepancies.

Further, the Assessee vaguely submitted that "if these outstanding balances turn out to be non-payable at any time in future," their auditors would then report the same in the Tax Audit Report for the relevant future year. This statement, in effect, sought to defer the taxability of these long-standing liabilities.

3. In this regard, it is submitted that the AO has correctly made an addition of 60,80,534/- to the Assessee's income. This addition pertains to sundry credit balances

that have remained outstanding for more than three years, on the unequivocal ground that there has been a cessation of liability in terms of Section 41(1) of the Act. The AO's stance is firm: since these sundry creditor accounts were lying dormant, it is rightly presumed that income has accrued to the Assessee on account of the remission or cessation of the underlying trade liability.

A. The Revenue submits that the prolonged dormancy of these liabilities, exceeding three years, strongly indicates a cessation in the eye of the law. While the Limitation.

Act specifies a time period within which a claim can be made, the legal principle of cessation extends beyond the mere barring of a remedy.

5. The Hon'ble Delhi High Court in CIT vs. Chipsoft Technology (P.) Ltd. [2012] 26 taxmann.com 109 (Delhi) has conclusively held that "even omission to pay, over a period of time and the resultant benefit derived by the Assessee would qualify as a cessation of liability albeit by operation of law. The Hon'ble Court expressly rejected the "abstract and theoretical" view that liability persists merely because it is reflected in books or that a lapse of time does not efface it. Significantly, with the introduction of an Explanation to Section 41(1) via the Finance Act, 1996 (No.2) with effect from April 1, 1997, the scope of "remission or cessation explicitly includes such an outcome. The use of the word "include" in the Explanation further broadens its ambit, confirming that a unilateral act or even a passive omission to pay, resulting in a benefit to the assessee, falls within its purview.

6. Further reinforcing this position, the Hon'ble Madras High Court in West Asia Exports & Imports (P.) Ltd. vs. ACIT [2019] 104 taxmann.com 170 (Madras) made crucial observations pertinent to the instant case. The Court clarified that "cessation" in Section 41(1) means "cessation de facto and de jure, which can be inferred from the surrounding facts and circumstances. Importantly, the Court observed that "After Explanation was added on Section 41(1), it can be even by the unilateral act on the part of Assessee viz., by writing back or writing off such liability amounting to cessation of liability in his hands attracting Section 41(1) of the Act and attracting tax thereon".

7. It is submitted that while the initial burden may be on the Revenue to establish cessation, this burden was duly discharged by calling upon the Assessee to produce written confirmations from these trade creditors. Upon this request, the onus unequivocally shifted to the Assessee to either produce such written confirmations or to present the creditors as witnesses to substantiate that the trade credit or liability to pay genuinely continues to exist, both de facto and de jure. The Assessee has failed to discharge this shifted onus.

8. That, the Hon'ble Madras High Court in West Asia Exports & Imports (P.) Ltd. (supra) has further emphasized that "entries in the books of accounts or more particularly balances drawn year after year in the Balance Sheets cannot perennially or indefinitely postpone the applicability of Section 41(1) of the Act on the ground of cessation of trading liability". Such an interpretation, as rightly held by the Court, would fundamentally defeat the very object and intent of enacting Section 41(1). The

clear objective of the provision is to tax any deduction or allowance claimed against previous years' profits if the corresponding liability ceases in law in a subsequent year.

9. Given that the sundry creditor balances of ₹60,80,534/- have remained outstanding for over three years, coupled with the Assessee's failure to provide any concrete evidence of a subsisting, live liability or active demands from the creditors, the only logical conclusion, in light of the settled legal position, is that there has been a cessation of these liabilities. The mere reflection of these amounts in the Assessee's books of account does not, in itself, prevent the application of Section 41(1). Therefore, the AO's addition is legally sound and fully justifiable, and it is respectfully submitted that this ground be dismissed.”

(emphasis supplied by us)

20.5 In rejoinder, the Sr. Counsel for assessee submitted as under:

108. In response to the Revenue's submission that the addition is required to be made on account of static creditors written-back, the Appellant seeks to place reliance on the following cases wherein the Delhi High Court held that outstanding liability, unless unilaterally written-back in books of account, cannot be treated as income under section 41(1) of the Act on the ground that the same has become barred by limitation:

- *CIT vs Hotline Electronics Ltd: 205 Taxman 245 (Del) [Refer para 7 to 10 @ pages 706-707 of the Case Laws Paper Book]*
- *CIT vs Shri Vardhman Overseas Ltd: 343 ITR 408 (Del) [Refer para 16 to 24 @ pages 716-720 of the Case Laws Paper Book]*
- *PCIT vs Soorajmul Nagarmull: [2022] 145 taxmann.com 245 (Cal)*
- *PCIT vs Eco Auto Components (P) Ltd: [2018] 409 ITR 202 (P&H)*

109. It is submitted that the total amount of outstanding balance of creditors of Rs.60,80,534 as on 31.03.2007 was either paid by the Appellant or was written back and offered to tax under section 41 of the Act in the later assessment year(s) in which the same was written back. Ledger accounts of the major creditors amounting to Rs.19.72 lakhs, which were written back and offered to tax in the subsequent AYs are enclosed at pages 14-29 of the Rejoinder Paper Book.

110. Thus, the addition made by the assessing officer under section 41(1) of the Act deserves to be deleted.”

(emphasis supplied by us)

20.6 We have heard both the parties and perused the material available on record. The AO added a sum of Rs. 60,80,534/- being outstanding sundry Creditors balance on 31.03.2007 more than three years u/s 41(I) of the Act. Both sides have relied upon various case laws in support of their respective submissions as reproduced and highlighted above. The Ld. Counsel in its rejoinder submitted that the total amount of outstanding balance of creditors of Rs.60,80,534 as on 31.03.2007 was either paid by the assessee or was written back and offered to tax under section 41 of the Act in the later assessment year(s) in which the same was written back. The assessee also submitted ledger accounts of the major creditors amounting to Rs.19.72 lakhs, which were written back and offered to tax in the subsequent AYs at pages 14-29 of the Rejoinder Paper Book. We, therefore, in view of the above submissions of the assessee restore this matter to the file of the AO for necessary verification of the claim of the assessee of either paying the outstanding balances or the balance amount being offered for taxation as the case may be. Upon verification, if the submissions of the assessee are found to be correct, then the AO is directed to delete the addition of Rs. 60,80,534/-. Accordingly, ground no. 12 and 12.1 of the appeal is allowed as indicated above.

21. To sum up, both the appeals of the assessee being ITA No.- 5624/Del/2010 and 5465/Del/2011 for A.Ys. 2006-07 and 2007-08 respectively are partly allowed.

Order pronounced in the open court on 15th April, 2026.

Sd/-

**[VIKAS AWASTHY]
JUDICIAL MEMBER**

Sd/-

**[BRAJESH KUMAR SINGH]
ACCOUNTANT MEMBER**

Dated- 15.04.2026.

Pooja.

Copy forwarded to:

1. Assessee
2. Respondent
3. CIT
4. CIT(A)
5. DR

Asst. Registrar,
ITAT, New Delhi,