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IN THE HIGH COURT OF DELHI AT NEW DELHI

ITA No. 1003 of 2008 & Cross-Objection No. 15335/2008
with
ITA No. 1028 of 2008 & Cross-Objection No. 15664/2009
and
ITA No. 1030 of 2008 & Cross-Objection No. 15666/2009

Reserved On: 26th October, 2009.

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Date of Decision: 05th February, 2010.

1) ITA No. 1003 of 2008 & Cross-Objection No. 15335/2009

COMMISSIONER OF INCOME TAX . . . Appellant

through : Ms. Prem Lata Bansal, Advocate.

VERSUS

ECS LIMITED . . . Respondent

through: Mr. Ajay Vohra with Ms. Kavita Jha,
Mr. Sriram Krishan and Ms. Akansha
Aggarwal, Advocates.

2) ITA No. 1028 of 2008 & Cross-Objection No. 15664/2009

COMMISSIONER OF INCOME TAX . . . Appellant

through : Ms. Prem Lata Bansal, Advocate.

VERSUS

ECS LIMITED . . . Respondent

through: Mr. Ajay Vohra with Ms. Kavita Jha,
Mr. Sriram Krishan and Ms. Akansha
Aggarwal, Advocates.

3) ITA No. 1030 of 2008 & Cross-Objection No. 15666/2009

COMMISSIONER OF INCOME TAX . . . Appellant

through : Ms. Prem Lata Bansal, Advocate.

VERSUS

ECS LIMITED . . . Respondent

through: Mr. Ajay Vohra with Ms. Kavita Jha,



CORAM :-

THE HON'BLE MR. JUSTICE A.K. SIKRI
THE HON'BLE MR. JUSTICE SIDDHARTH MRIDUL

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest? *Yes*

A.K. SIKRI, J.

1. In these three appeals preferred by the Revenue, we are concerned with the validity of the orders passed by the Income Tax Appellate Tribunal (hereinafter referred to as 'the Tribunal') deleting the penalty levied under Section 271(1)(c) of the Income Tax Act (hereinafter referred to as 'the Act') and in respect of Assessment Years 1994-95, 1995-96 and 1996-97. The reason for passing penalty orders by the Assessing Officer (AO) in all the three Assessment Years are recapitulated below:

The respondent/assessee is a company engaged in the business of providing consultancy services. Consultancy services were provided to some foreign clients from whom the appellant earned foreign exchange. To the extent, any expense is incurred in foreign currency, the same is reduced from the foreign consultancy income and deduction under Section 80-O of the Act claimed @ 50% of the net foreign consultancy income. No expenses incurred in India are allocated/apportioned to earning of foreign consultancy income. Section 80-O of the Act, as it stood at material time reads as under:

"Section 80-O. DEDUCTION IN RESPECT OF ROYALTIES, ETC., FROM CERTAIN FOREIGN ENTERPRISES.



India includes any income received by the assessee from Government of a foreign State or foreign enterprise in consideration for the use outside India of any patent, invention, design or registered trade mark, and such income is received in convertible foreign exchange in India, or having been received in convertible foreign exchange outside India, or having been converted into convertible foreign exchange outside India, is brought into India, by or on behalf of the assessee in accordance with any law for the time being in force for regulating payments and dealings in foreign exchange, there shall be allowed, in accordance with and subject to the provisions of this section, a deduction of an amount equal to fifty per cent of the income so received in, or brought into, India, in computing the total income of the assessee :

2. Deduction under the said Section was admissible @ 50% of the income received in convertible foreign exchange from rendering technical services outside India and brought into India. The respondent/assessee claimed deduction under Section 80-O in respect of all the three Assessment Years qua the foreign consultancy income earned by it. While doing so, it made computation of deduction with reference to the foreign exchange received and brought in India. The assessee did not enter the expenses incurred in India in the computation of deduction under the aforesaid provision. The deduction claimed, in the aforesaid manner, was not acceptable to the AO. Holding that expenses incurred in India have to be suitably allocated/apportioned to the foreign consultancy income and deduction under Section 80-O of the Act, he quantified the deduction with reference to the net foreign consultancy, after taking into account the expenses incurred in India. The year-wise position of foreign consultancy income earned, deduction under Section 80-O of the Act claimed by the appellant and deduction



Assessment Year	Foreign Consultancy Income	Deduction under Section 80-O	
		Claimed by the Assessee	Allowed by the Assessing Officer
1994-95	Rs.15,74,543/-	Rs.7,87,272/-	Rs.68,437/-
1995-96	Rs.38,74,260/-	Rs.19,97,637/-	1,76,630/-
1996-97	Rs.1,20,92,449/-	Rs. 60,46,224/-	Rs.4,49,947 + allowed by ITAT and confirmed by the High Court. Rs.67,82,500

3. The order of the AO was upheld by the CIT(A) as well as Tribunal.
4. In view of the short allowance of deduction under Section 80-O of the Act, the AO imposed the penalty in respect of all these three Assessment Years. The appeal preferred by the assessee against the penalty orders was dismissed by the CIT(A), who confirmed the imposition of penalty. On further appeal to the Tribunal, the assessee contended that penalty under Section 271(1)(c) of the Act was not exigible in respect of short allowance of deduction under Section 80-O of the Act, *inter alia*, on the following grounds:
 - a) The issue whether Indian expenses were to be taken into account for purposes of calculation of deduction, at the time of the filing of the return of income, was debatable.
 - b) No satisfaction was recorded in the assessment order while initiating proceedings under Section 271(1)(c) of the Act.
 - c) The AO having allocated/apportioned Indian expenses on estimate basis, the same could not constitute ground



5. The Tribunal by a combined order deleted the penalty levied on Assessment Years 1994-95 to 1996-97 on the grounds that (a) no satisfaction for initiation of penalty proceedings was discernible from the reading of the assessment orders; (b) the short allowance of deduction under Section 80-O of the Act being made on estimate, the assessee could not be penalized by way of levy of penalty for furnishing inaccurate particulars of income. The Tribunal did not, however, accept the other submission of the assessee *viz.* since the issue whether Indian expenses would enter the computation of deduction under Section 80-O of the Act was debatable, at the time when the return of income was filed, no penalty was exigible. According to the Tribunal the matter stood conclusively settled against the assessee by the jurisdictional High Court decision in the case of *Commissioner of Income Tax Vs. Marketing Research Corporation* [61 CTR 204 (Del.)].
6. The Revenue has come up in appeal against the order of the Tribunal deleting the penalty levied under Section 271(1)(c) of the Act. The assessee had also filed cross appeals bearing Appeal Nos. 1248, 1258 and 1308 of 2008. The appeals preferred by the assessee were dismissed vide order dated 26.10.2009 on the ground that the same shall be regarded as cross-objections in the appeals filed by the Revenue and that the averments made in those appeals would be considered in appeals filed by the Revenue.
7. In the aforesaid circumstances, we have also to rule on the contention



assessee that expenses incurred in India would not be taken into account for purposes of calculation of deduction while determining the following substantial question of law:

“Whether the ITAT was correct in law in deleting the penalty imposed by the Assessing Officer under Section 271(1)(c) of the Act?”

8. We take up three limbs of this issue in the following order:

(a) **Re: Whether no satisfaction is recorded in the assessment order, if so, its effect.**

Section 271(1)(c) of the Act has been amended retrospectively with effect from 01.04.1989 vide Finance Act, 2008 where Clause (1B) in explanation to Section 271(1) (c) has been inserted. As per this Clause, it is not necessary for the AO to record is satisfaction while initiating penalty proceedings. The vires of this provision were challenged by filing a writ petition in the Court. In the said case entitled *Madhushree Gupta and British Airways LC vs. Union of India and Another* [317 ITR 107] while upholding the validity of the aforesaid amendment, the Division Bench was of the opinion that provisions are to be read down and held that even after the amendment if the satisfaction is not discernible from the assessment order, penalty cannot be imposed. This would be clear from the reading of Paras 19 and 20 of the said judgment, wherein the conclusions are summarized by the Court in the following manner:



(i) Section 271 (1B) of the Act is not violative of Article 14 of the Constitution.

(ii) **The position of law both pre and post amendment is similar, in as much, the Assessing Officer will have to arrive at a prima facie satisfaction during the course of proceedings with regard to the assessee having concealed particulars of income or furnished inaccurate particulars, before he initiates penalty proceedings.**

(iii) **'Prima facie' satisfaction of the Assessing Officer that the case may deserve the imposition of penalty should be discernible from the order passed during the course of the proceedings. Obviously, the Assessing Officer would arrive at a decision, i.e., a final conclusion only after hearing the assessee.**

(iv) At the stage of initiation of penalty proceeding the order passed by the Assessing Officer need not reflect satisfaction vis-a-vis each and every item of addition or disallowance if overall sense gathered from the order is that a further prognosis is called for.

(v) However, this would not debar an assessee from furnishing evidence to rebut the prima facie satisfaction of the Assessing Officer; since penalty proceeding are not a continuation of assessment proceedings. [See Jain Brothers v. Union of India: (1970) 77 ITR 107(SC)]

(vi) Due compliance would be required to be made in respect of the provisions of Section 274 and 275 of the Act.

(vii) the proceedings for initiation of penalty proceeding cannot be set aside only on the ground that the assessment order states 'penalty proceedings are initiated separately' if otherwise, it conforms to the parameters set out hereinabove are met.

20. In view of the above we reject the prayers made in the writ petitions with the caveat that provisions of Section 271 (1) (c) post- amendment will be read in the manner indicated above.

The net effect of the aforesaid judgment is that even when the AO has not recorded his satisfaction in explicit terms, the assessment orders should indicate that the AO had arrived at such a satisfaction. Though the assessment order need not



find out that the order is couched in such a manner discussion herein leads towards the opinion of the AO that the assessee had concealed particulars of income or furnishing inaccurate particulars. This has to be discerned from the reading of the assessment order. We have gone through the assessment orders passed in these cases keeping in mind the aforesaid yardstick in mind. In the assessment orders passed by the AO in the instant case, after discussing the proposition that expenses incurred in India are to be entered while computing deduction under Section 80-O of the Act and disallowing major part of the expenses claimed by the assessee, the AO mentioned at the end in the assessment order as under:

“Penalty proceedings under Section 271(1)(c) are being initiated separately.”

Admittedly, the AO has not stated, in so many words, that he was satisfied that the assessee had concealed particular of income or furnished inaccurate particulars. However, it shows that during the assessment proceedings, the AO found that the assessee had claimed deduction under Section 80-O of the Act @ of 50% of its gross income earned in foreign exchange and not @50% of net income earned in foreign exchange. In these circumstances, the AO asked the assessee to furnish details of expenditure incurred to earn the income in foreign exchange by giving specific notice. The assessee, however,

when the case was adjourned



assessee to explain as to why the expenditure relating to the assessee's earning in convertible foreign exchange should not be estimated. In response to such show-cause notice, the assessee came out with the plea that the expenditure incurred in India to earn foreign exchange was not to be deducted. In this behalf, the AO noted as under:

"I have considered the above submission made by the assessee made by the assessee. I find that the assessee company has only described the general customary practices in the business of consultancy but has not furnished any evidence to show that direct expenses relatable to their earning in foreign exchange have been borne by their clients or recovered from them. I find from the Schedule of P & L Account that expenditure of 38.03 lacs have been incurred on travelling, 6.83 lacs on consultancy fee, 26.72 lacs on communication and 9.32 lacs on training and development. These expenditures cannot be de-associated with the earning in foreign exchange.

(emphasis supplied)"

The AO thereafter discussed the legal position relating to the deductions admissible under Section 80-O of the Act answering by referring to certain judgments that the contention of the assessee by holding that the correct position of law is that the expenses are to be deducted from such foreign exchange income before claiming deduction under Section 80-O of the Act. He thereafter mentioned that:

"The assessee has not furnished the details of amount of expenditure relatable to the earning of income in foreign exchange despite opportunity given repeatedly. Moreover, the assessee not only interpreted the law wrongly but also did not furnish the details of expenditure attributable to such foreign income."



expenditure in the ratio of proportion of foreign income to total income, which was Rs.12.27%. Thereafter, he calculated the eligible deduction under Section 80-O, arrived at the taxable income, and observed that the penalty under Section 271(1)(c) of the Act had been initiated.

It becomes clear from the reading of the assessment order in its entirety that the AO has been influenced by the consideration that not only the assessee had interpreted the law wrongly, but also did not furnish the details of expenditure attributable to such foreign income because of which penalty proceedings under Section 271(1)(c) were initiated by him. Thus, his *prima facie* satisfaction about non-furnishing of particulars/inaccurate particulars is clearly discernible.

(b) **Re: Estimated Disallowance under Section 80-O:**

The submission of the learned counsel for the assessee in this behalf was that the AO while computing assessment under Section 80-O of the Act allocated/apportioned Indian expenses debited in the Profit & Loss Account in the proportion of foreign income to total income. The very expenditure which was disclosed in the books of accounts was allocated and apportioned by the AO to arrive at the net foreign consultancy income on the basis of which reduction under Section 80-O of the Act was made @ 50%. The AO was not able to pinpoint



restored to an estimate to disallow part of the deduction under Section 80-O as claimed by the assessee. He thus argued that in these circumstances, it was rightly held by the Tribunal that the estimated disallowance made by the AO out of the claim of deduction under Section 80-O of the Act was not on account of any expenditure, which was found to be bogus or excessive. We may also note that going by the aforesaid circumstance, the Tribunal has held that the assessee was not guilty in furnishing inaccurate particulars to sustain levy of penalty and has relied upon the following judgments:

- i) ***Commissioner of Income Tax Vs. Prem Dass*** [248 ITR 234 (P & H)];
- ii) ***Commissioner of Income Tax Vs. Ajaib Singh & Co.*** [253 ITR 630 (P&H)]; and
- iii) ***Hargopal Singh Vs. Commissioner of Income Tax*** [258 ITR 85 (P&H)].

In the aforesaid cases, it was held that where the assessee's returned his income on estimate basis but the AO as well as the CIT (A) admitted the different estimate, it was a case of difference of opinion and on estimation of disallowance, no penalty under Section 271(1)(c) can be made. No doubt, in those cases where there would be difference of opinion as regards estimate, it cannot be said that the assessee had concealed the particulars of income. However, that is not the position in the instant case. We are of the opinion that the Tribunal had wrongly placed reliance on the judgments, which



deduction under Section 80-O of the Act, wanted the 50% of the gross income received in convertible foreign exchange in India provided by it to foreign clients. The AO, however, was of the view that on correct interpretation under Section 80-O, deduction is restricted to the net income and, therefore, expenditure incurred in India for earning the foreign exchange had to be deducted. The AO, therefore, wanted the assessee to furnish the details of expenses. As the assessee failed to do the needful in respect of various particulars demanded, the AO was left with no alternative but to estimate such expenditure in the ratio of proportion of foreign income to the total income.

We are, therefore, of the opinion that the Tribunal is not correct in holding that since the expenditure was arrived at on the estimation, the penalty cannot be imposed. Things would have been different, had the assessee furnished the details, but for some reason, the AO had adopted another yardstick. That is not the situation here.

(c) **Re: Cross-Objection:**

As pointed out earlier, the assessee had also raised one more ground before the Tribunal, *viz.*, the issue relating to the adjustment of expenses and entitlement of deduction under Section 80-O on the gross income or net income was a debatable issue at that time, as there were conflicting judicial opinions of different Courts/Benches of Tribunal. The Tribunal, however, has opined that there was no cleavage of



Tribunal has relied upon the decision of the Supreme Court in the case of *Distributors (Baroda) Pvt. Ltd. Vs. Union of India* [155 ITR 120] and the decision of this Court in the case of *Commissioner of Income Tax Vs. Marketing Research Corporation* (1987) [61 CTR 204] in support of its conclusion that on the date of filing of return, the controversy was well-settled, *viz.*, the deduction under Section 80-O of the Act had to be allowed on net income.

In the cross-objections filed by the assessee, this finding of the Tribunal is assailed. The argument advanced by the assessee, in this behalf, has two limbs. In the first place, it is argued that the Tribunal has completely missed the import/merit of appellant's arguments. The controversy raised by the appellant was not whether the deduction under Section 80-O had to be allowed on gross or net income. It is the settled proposition of law that deduction under Section 80-O had to be allowed only on net income. The controversy in dispute was whether expenses incurred in India could be apportioned to the earning of foreign consultancy income for purposes of allowing deduction under the said Section was admissible @ 50% of the income in convertible foreign exchange. The Section does not refer to the expenditure incurred in India. The decision of this Court in *Marketing Research Corporation* (supra) relied upon by the Tribunal was in the context of provisions of



provisions of the said Section as applicable to the year
appeal. It was argued that despite this decision, the matter was
referred to Full Bench by this Court in *Commissioner of
Income Tax Vs. Chemical & Metallurgical Design Co. Ltd.*
[161 CTR 317 (Del.)]. The judgment of the Full Bench in that
case, which is reported as 247 ITR 749 (Del) (FB)], rendered
on 15.12.2000 that the issue was finally determined holding
that in view of Section 80AB of the Act, deduction under
Section 80-O of the Act had to be allowed on the net income
after taking into account expenses incurred, including in India.

Other limb of the argument is that even if the deduction
was allowed on the net amount of foreign exchange after
deducting the expenditure incurred in India, the same would
not give rise of penalty for concealment of income or furnishing
inaccurate particulars thereafter, as the assessee was able to
demonstrate that claim made was *bona fide* and material
particulars relating to were duly disclosed.

9. It is clear from the aforesaid arguments that the learned counsel for the assessee accepts that there was no controversy at least to the extent that deduction under Section 80-O had to be allowed only on net income. According to him, however, in the process of arriving at net income, whether expenditure incurred even in India was to be deducted or not was in the realm of controversy on which no authoritative pronouncement was there. Therefore, while preferring



move since the issue was debatable for want of authoritative pronouncement. This contention based on artificial distinction made between expenditure incurred abroad and in India does not appeal to us. Way back in the year 1985, the Supreme Court had interpreted these provisions in the case of *Distributors (Baroda) Pvt. Ltd.* (supra). The categorical view of the Supreme Court was that the deduction required to be allowed was available only with respect to net amount as computed for the purpose of assessment to tax and not actual amount received. The Court was concerned, in that case, with the provision of Section 80M of the Act relating to the deduction in respect of income from dividend. Legislative history of this provision along with Section 80A(2) and 80AA was taken note of along with various earlier pronouncements. Relying upon this judgment, this Court in *Marketing Research Corporation* (supra), which pertains to Section 80-O of the Act reiterated that the deduction had to be computed not on the basis of gross income, but on the basis of net income. This judgment of the jurisdictional Court was binding on all the authorities including AO, CIT(A) as well as ITAT. Reason for referring the matter to a Larger Bench was that the decision of Division Bench in *Marketing Research Corporation* (supra) was *ex parte* and it was also argued that there was material difference in the language of Section 80-O and 80M and, therefore, ratio of the Supreme Court in *Distributors (Baroda) Pvt. Ltd.* (supra) was not applicable while interpreting the provision of Section 80-O of the



(supra) referring the matter of Larger Bench. However, it is interesting to note that this reference was made on 14.03.2000. In the present case, returns were filed and the assessment orders were made much prior to that, therefore, the assessee cannot take advantage of this reference order as he could not have foreseen that there would be a reference to a Larger bench in future on such an issue. Moreover, merely because the matter was referred to the Larger Bench would not mean that the effect of the Division Bench's order in *Marketing Research Corporation* (supra), which the Full Bench on that date and was binding on the authorities below was nullified. When this was a binding legal position prevailing at relevant time, in view of the aforesaid judgment of jurisdictional Court, the learned counsel for the assessee cannot be allowed to create the confusion or artificial controversy by referring to the decisions of the various Benches of the Tribunal.

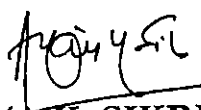
10. We are, thus, of the opinion that the Tribunal was right in holding that there was no cleavage of opinion. Once the principle was laid down that the deduction under Section 80-O had to be allowed only on net income, it was but obvious that expenditure incurred in India had also to be deducted to arrive at such a "net income".
11. Insofar as *bona fide* of the assessee is concerned, we would do no better to quote the following discussion from the order of the CIT(A), with approval:

"It was worth noting that the appellant has relied upon the case laws of other High Court ignoring the judgment of Hon'ble



to claim higher deduction and thus escaping the imposition of taxes. It is settled now that claiming excessive deductions also amount to concealment of income. Falsehood in accounts can take either of the two forms: either an item of receipt may be suppressed fraudulently, or an item of expenditure may be falsely claimed. Both types attempt to reduce the taxable income. Both types amount to concealment of particulars of one's income as well as furnishing of inaccurate particulars of income. Penalty may be imposed for either or both such attempts [CIT v/s India Sea Foods, 1976 105 ITR 708, Kerala; Nagin Chand Shiv Sahai v/s CIT (1938) 6 ITR 534 (Lah); CIT v/s Gates Foam and Rubber Company (1973) 91 ITR 467 (Ker)]. It is not right to say on the part of the appellant that the Assessing Officer has to record the satisfaction before initiating the penalty proceedings under Section 271(1)(c) for the reason that the factum of concealment on account of furnishing inaccurate particulars of one's income clearly emanates from the assessment order and I consider the same as recording of satisfaction on the part of the Assessing Officer."

12. The upshot of the aforesaid discussion would be to hold that the penalty was rightly imposed by the Assessing Officer and confirmed by the CIT(A). We accordingly decide the question of law framed in favour of the Revenue and against the assessee and thereby set aside the order of the Tribunal and restore the penalty orders passed by the Assessing Officer.
13. We, however, leave the parties without any costs.


(A.K. SIKRI)
JUDGE


(SIDDHARTH MRIDUL)
JUDGE

FEBRUARY 05, 2010.

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