* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Reserved on : November 14th, 2011.
% **Date of Decision : 14th December, 2011.**

\+ ITA 1194/2008

COMMISSIONER OF INCOME TAX DELHI IV .... Petitioner
Through Mr. Kiran Babu, Sr. Standing Counsel/Income Tax Deptt.

versus

EHPT INDIA P. LTD. ..... Respondent
Through Dr. Rakesh Gupta, Advocate with Ms. Rani Kiyala, Advocate.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE R.V. EASWAR

1. Whether Reporters of local papers may be allowed to see the judgment?
2. To be referred to the Reporters or not ? Yes
3. Whether the judgment should be reported in the Digest? Yes

R.V. EASWAR, J.:

For detailed order, see ITA No.1172/2008.

R.V.EASWAR, J.

SANJIV KHANNA, J.

December 14, 2011
mm/Bisht

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Through Mr. Kiran Babu, Sr. Standing Counsel/Income Tax Deptt.

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EHPT INDIA P. LTD. ..... Respondent
Through Dr. Rakesh Gupta, Advocate with Ms. Rani Kiyala, Advocate.

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1. Whether Reporters of local papers may be allowed to see the judgment?
2. To be referred to the Reporters or not ? Yes
3. Whether the judgment should be reported in the Digest? Yes

R.V. EASWAR, J.:

These are two appeals filed by the revenue under Section 260A of the Income-tax Act ("Act", for short) against the common order passed by the Income Tax Appellate Tribunal ("Tribunal", for short) on 31-1-2008 in ITA Nos.2395/DEL/2005 & 93/DEL/2006 for the assessment years 2001-02 and 2002-03 respectively. On 23-7-2010 the appeals were admitted and the following substantial questions of law were framed:

> "(a) Whether Income Tax Appellate Tribunal was correct in law in accepting "head-count" method of distribution of expenses adopted by the assessee for allocation of indirect expenses between STP unit and non-STP unit?
>
> b) Whether Income Tax Appellate Tribunal was correct in law in applying Rule of consistency when the method of allocation adopted by the assessee was not the correct method of accounting?
>
> c) Whether Income Tax Appellate Tribunal was correct in law in discarding the method of distribution adopted by Assessing Officer which was in accordance with the provisions contained in Section 10A (iv) of the Act itself?
>
> d) Whether order passed by Income Tax Appellate Tribunal is perverse in law and on facts?"

2. The respondent-assessee is a private limited company resident in India. During the relevant previous years, it operated two units: a Software Technological Park unit ("STP unit", for short) which was engaged in the development of software which was primarily exported to the parent company in Sweden and another domestic unit (non-STP unit) which was primarily engaged in the implementation of the

telecom software for vendors/customers in India. In respect of the profits from the STP unit the assessee was undisputedly entitled to the deduction provided in Section 10A of the Act. In the returns filed for the years under appeal the assessee computed the profits from the STP unit by apportioning the indirect or common expenses on the basis of the head-count of the employees working in the said unit and the domestic unit and claimed the deduction u/s.10A in respect of the former unit accordingly. For instance, we may take up the computation of the profits from the STP unit for the assessment year 2001-02 which according to the assessee was as under:

"Indirect Expenses Allocated to the Units

Presently considered	**STP Unit**	**Non STP Unit**	**Total**
Direct Common expenses	4765138		4765138
Information Technology Expenses	28932001	1499544	30431545
Other common Expenses	63396248	2493829	65890077
G&A expenses	23683830	830265	24514095
	120777217	4823638	125600855(A)

While completing the assessment under Section 143(3) of the Act, the Assessing Officer was of the view that the apportionment of the common or indirect expenses between the two units – STP and domestic – on the head-count basis was not appropriate and it resulted in more profits being shown from the STP unit. He therefore called upon the assessee to justify the apportionment. The assessee submitted

its reply in writing which is reproduced in page 2 of the assessment order, the gist of which is that the common expenses were recorded separately in the cost centers maintained for the purpose and the same were apportioned in the ratio of head count for arriving at the total expenses of the two units.

3. The Assessing Officer considered the explanation of the assessee to be unacceptable. He was of the view that the common expenses should have been apportioned on the basis of the turnover in the respective units and that method "would have been a much more logical basis for apportioning of these expenses". He accordingly apportioned the total indirect expenses of Rs.12,56,00,825 in the ratio of the turnover in the two units in the following manner:

"Turnover:	339000025 (B)	2200000(C)	341200025(D)
Allocation of the indirect expenses:	124791002	809853	123600855
In the Ratio of turnover	[(A)/(D)*(B)]	[(A)/(D)*(C)]	
Difference	(4013785)	4013785"	

It may be seen from the above re-apportionment made by the Assessing Officer on the basis of the turnover, that the common expenses attributable to the domestic unit came to only Rs.8,09,853 as against Rs. 48,23,638/- apportioned by the assessee by following the head-count method. He therefore disallowed the difference of Rs.40,13,785/- claimed in the domestic (non-STP) unit. The result was that the taxable income from the non-STP or domestic unit got enhanced by the aforesaid amount.

4. Aggrieved by the method of apportionment adopted by the Assessing Officer and the enhancement of the income of the taxable domestic unit, the assessee filed an appeal before the Commissioner of Income Tax (Appeals) (CIT(A), for short). It was submitted before him that (a) the units were operating on project basis and the expenditure was attributable to each project for which the head-count basis was more appropriate; (b) the method of apportioning the indirect or common expenses on the basis of head-count had been adopted by the assessee consistently in the past and was also accepted without demur by the income-tax authorities; (c) that though there is no judicial precedent available as to what would be the best method of apportionment in such cases, but the turnover basis adopted by the Assessing Officer was more suited to manufacturing concerns, whereas the head-count basis was more appropriate for service industry; and (d) the method adopted by the assessee not having been found to be unreasonable or inconsistent with commercial accounting principles, should not be disturbed. In support of these submissions, the assessee relied on the judgment of the Madras High Court in ***Madras Co-operative Central Land Mortgage Bank Ltd. v. Commissioner of Income Tax (1968)67 ITR 89*** *and the judgment of the Supreme Court in* ***Hukumchand Mills Ltd. V CIT (1976)103 ITR 548***.

5. The CIT(A) dismissed the contentions of the assessee with the following observations:

> "In the cases relied upon by the appellant counsel of Madras Coop Central and Mortgage Ltd., and Hukum Chand Ltd. (supra), the apportionment has been done on

the basis taken into consideration the facts of the case in the two cases. As admitted by the appellant, it is a fact that the judicial precedence is not available on the issue how the expenditure is to be allocated between the two units. Though the appellant counsel is talking of commercially accountable principles but the appellant has not filed what are those in relation to his line of business. As there are no provision in the IT Act nor any accounting principles have been relied upon by the appellant, the expenses are required to be allocated between the two units on some sound basis. The allocation of the expenditure by the appellant on head count basis is totally incorrect as the expenditure cannot be allocated on the basis of the person employed in the two units. The only sound basis which comes to the mind is that adopted by the Assessing Officer to distribute the same on the basis of turnover. In view of the same, the ASSESSING OFFICER has rightly allocated the expenditure and the action of the Assessing Officer is upheld."

6. The assessee carried the matter in appeal before the Tribunal. Before we notice the decision of the Tribunal, it needs to be mentioned that the assessment for the assessment year 2002-03 had also been completed in the meantime by order dated 18-3-2005 passed under Section 143(3) of the Act and in that order also the Assessing Officer had adopted the same basis of apportionment of the indirect expenses which he had adopted in the order for the assessment year 2001-02. However, there is one difference which must be noticed. In respect of the assessment year 2002-03, the assessee was able to show in the appeal filed before the CIT(A) that there was an error in the calculation of the disallowance made by the Assessing Officer on the basis of turnover and that even if the turnover basis of apportionment of the indirect expenses is adopted, as was done by the Assessing

Officer, then the correct amount of deduction available to the assessee in the domestic unit would actually be Rs.6,53,49,442/- as against Rs.6,51,50,217/- claimed by it on the basis of head-count. Thus, if the turnover method, rather than head count method is adopted, in this year, the taxable income from non-STP unit would fall and STP income would increase to the advantage of the Assessee. The CIT(A) held that this claim of the assessee was correct, though in principle he upheld the method adopted by the Assessing Officer (i.e., the turnover basis). However, since the assessee had shown more taxable income from the domestic non-STP unit under the head-count method, he did not disturb the amount of deduction claimed by the assessee and eventually deleted the addition made by the Assessing Officer (based on incorrect figures).

7. The assessee filed an appeal before the Tribunal in ITA No.2395/DEL/2005 for the assessment year 2001-02 and the Revenue filed an appeal before the Tribunal in ITA No.93/DEL/2006 for the assessment year 2002-03. The Revenue had filed the appeal before the Tribunal because the CIT(A) for that year deleted the disallowance of the expenses in the computation of the income of the domestic unit even though he had upheld the method adopted by the Assessing Officer in apportioning the indirect expenses on the basis of the turnover of the respective units to be correct. The Tribunal examined the appeals in the light of the submissions made before it and recorded the following findings:

a) That the computation of the export profit u/s.10A has to be made separately for each eligible undertaking in a case where

the assessee has more than one undertaking because of the language of sub-section (4);

b) That the assessee in the past was consistently following the method of apportioning the indirect expenses on the basis of the head-count and the same was also accepted by the income-tax authorities;

c) That therefore there was no justification for disturbing the method adopted by the assessee.

In the aforesaid view of the matter, the Tribunal upheld the method adopted by the assessee, allowed the assessee's appeal and dismissed the department's appeal.

8. We have examined the matter in the light of the submissions made before us. The fate of the appeals must depend upon the answer to the question whether the method adopted by the assessee, namely, that of apportioning the indirect expenses between the STP unit and the non-STP domestic unit on the basis of the "head-count" is an unreasonable method and if it has been followed consistently by the assessee in the past and has also been accepted by the department, should the revenue authorities be permitted to disturb the same in the years under appeal. It seems to us that the settled position in such matters is to examine whether the method which is canvassed for acceptance is the one (a) which has been consistently accepted by both the parties, namely, the assessee and the revenue in the past; (b) which is a reasonable method having regard to the nature of the business and other relevant factors and (c) which does not distort the

profits. There is no dispute that the head-count method has been consistently followed and accepted without demur in the past. A departure therefrom is sought to be made only in the years under consideration by the departmental authorities. That it is a reasonable method and fair to both sides is indicated by the conduct of the revenue authorities in accepting it in the past. The reasonableness or fairness of the method of head-count adopted by the assessee can be said to be indicated by the fact that in the assessment year 2002-03 the assessee apportioned more common expenses to the STP unit, thereby reducing its profits and consequently reducing the claim for deduction under Section 10A and at the same time offering a higher income in the domestic unit than what would have been offered had the turnover method of apportionment adopted by the Assessing Officer been followed. This aspect has been noticed by the CIT(A) in his order for the assessment year 2002-03 as follows:

> "In view of the above facts, though the right course of allocating the common expenses is on the basis of turnover basis. The appellant had filed a calculation on turnover basis, the deduction available to the appellant company comes to Rs.6,53,49,442 instead of Rs.6,51,50,217 claimed by the appellant. The working given by the appellant counsel has been found to be correct. In view of the above facts, as the assessee had shown more income though the right course of allocation for indirect expenses is turnover basis but as the appellant company had shown more income, the same is to be accepted and cannot be disturbed. In view of the above, no disturbance is required to be made in respect of indirect expenses allocated by the appellant company. In view of the above facts, the addition made by the Assessing Officer is deleted."

It was only as a matter of principle that the CIT(A) upheld the method adopted by the Assessing Officer even though the result was in favour of the assessee. Neither the Assessing Officer nor the CIT(A) has raised any serious questions about the validity of the head-count method adopted by the assessee nor have they pointed out any commercial accounting principle or accounting standard that repudiates the method.

9. Section 10A provides for deduction for profits derived from the export of software for a period of ten years. During the period of tax-holiday, it is desirable that the same method of computing the profits of the STP unit is adopted so that any distortion is avoided. We must however clarify that we are not to be understood as laying down as a proposition that in all cases arising under Section 10A, where the question of apportionment of common/indirect expenses between the taxable and the exempt units arises, the head-count method is the most appropriate method. The question will have to depend, in the very nature of things, on the nature of the business and the facts of the particular case. Our decision is confined to the facts of the present case. In the present case, there is no finding by the revenue authorities that by adopting the head-count method which was hitherto being accepted by them there was a distortion of the profits nor have they said that the head-count method of accounting is not the correct method of accounting. All that they have said is that in their opinion the turnover basis of apportionment of the expenses is more logical and needs to be applied. In the present case, the Assessing Officer has accepted the head-count method adopted by the assessee in the past

but has rejected it only for the years under appeal. This would disturb or distort the profits. The question whether the head-count method is the most appropriate method has been raised by the Assessing Officer in the course of the assessment proceedings and it has been stated by the assessee that though the turnover basis preferred by the Assessing Officer may be more suited to manufacturing businesses, in the case of service industry such as the assessee's case the head-count method would be more appropriate to be followed for the purpose of apportioning the indirect expenses. It appears to be a plausible view, though it can possibly also be a debatable view. But merely because there can be more than one method of apportioning the common expenses between the STP and domestic units it cannot be said that the method of head-count followed by the assessee should be discarded, that too mid-way, even though it was not questioned at any time in the past.

10. The provisions of sub-section (4) of section 10A, relied upon by the Assessing Officer, apply for the purpose of segregating the profits of the business into export profits and domestic profits. It is a statutory formula for ascertaining what are profits derived from the export of the eligible items. It has to be read with sub-section (1). It says that the export profits have to be apportioned on the basis of the ratio which the export turnover bears to the total turnover of all the businesses of the eligible undertaking. We are not in the present case concerned with sub-section (4). That sub-section will apply when the combined profits – profits of the exempt unit and those of the non-exempt unit – have been ascertained; the next step will be to apportion

them on the basis of the ratio which the export turnover bears to the total turnover. What we are concerned herein is the stage before that. We are concerned herein with the method by which the indirect or common expenses – expenses which are incurred for both the exempt and taxable units – are to be apportioned between the two units. To apply the formula prescribed in sub-section (4) may be appropriate in a given case considering its peculiar facts. But applying the same formula to all cases of apportionment without having regard to the history of assessments and other relevant factors may not be justified.

11. In ***Hukam Chand Mills Ltd. (supra)***, in the context of apportioning profits accruing to the assessee under the several categories of businesses carried on by him in British India, it was held that the question as to the method of apportionment was essentially one of fact depending upon the circumstances of the case. It was recognized that in the absence of any statutory or fixed formula, any finding on the question would involve an element of guess work and that "the endeavor can only be to be approximate and there cannot in the very nature of things be great precision and exactness in the matter" (at page 552). In the recent judgment of the Supreme Court in ***CIT v Bilahari Investment P. Ltd. (2008) 299 ITR 1***, the facts were these. The assessee was subscribing to chits and was maintaining the accounts on mercantile basis. The discount on the chits, which was actually the profit arising to the assessee, was declared at the end of the chit period, which at times exceed a period of 12 months. This method adopted by the assessee was being accepted by the department for a number of years. However, for the assessment years 1991-92 to

1997-98 the Assessing Officer took the view that the discount on the chits should be assessed every year, taking into account the number of instalments paid and remaining to be paid. The contention of the assessee was that the method adopted by him has been consistently accepted in the past and there was no justification for any departure. Accepting the submission, the Supreme Court held as under:

> "As stated above, we are concerned with the assessment years 1991-92 to 1997-98. In the past, the Department had accepted the completed contract method and because of such acceptance, the assessee, in these cases, have followed the same method of accounting, particularly in the context of chit discount. Every assessee is entitled to arrange its affairs and follow the method of accounting, which the Department has earlier accepted. It is only in those cases where the Department records a finding that the method adopted by the assessee results in distortion of profits, the Department can insist on substitution of the existing method. Further, in the present cases, we find from the various statements produced before us, that the entire exercise, arising out of change of method from the completed contract method to deferred revenue expenditure, is revenue neutral. Therefore, we do not wish to interfere with the impugned judgment of the High Court."

In the light of the observations of the Supreme Court in ***Hukum Chand Mills Ltd. (supra)***, in a case where alternative methods of apportionment of the expenses are recognized and there is no statutory or fixed formula, the endeavour can only be towards approximation without any great precision or exactness. If such is the endeavour, it can hardly be said that there is an attempt to distort the profits. On the contrary, as we have already pointed out, distortion of profits may arise if the consistently adopted and accepted method of

apportionment is sought to be disturbed in a few years, especially in a case such as the present one where the deduction under Section 10A is available over a period of ten years and only in some years the method of apportionment of income is disturbed. In other words, there is no "just cause" made out for abandoning the past method.

12. We accordingly answer the first three substantial questions of law in the affirmative and in favour of the assessee. The last question raises the issue of perversity in law and on facts. For the reasons given by us, it will be clear that the order of the Tribunal is based on proper reasons and settled principles of law taking note of all the facts and relevant circumstances of the case. The factual finding that the method adopted by the assessee has been consistently accepted by the departmental authorities is not under challenge. No just cause has been made out by the department for a departure from the past assessments. In these circumstances, we hold that the order passed by the Tribunal cannot be said to be vulnerable to the charge of perversity either on facts or in law. The last question is thus answered in the negative and against the revenue. The appeal filed by the Revenue is accordingly dismissed with no order as to costs.

R.V.EASWAR, J.

SANJIV KHANNA, J.

December 14, 2011
mm/Bisht