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

Reserved on: 12th February, 2014

% *Date of Decision: 21st February, 2014*

\+ **W.P. (C) 811/2012**

AT & T COMMUNICATION SERVICES INDIA (P) LTD.
..... Petitioner
Through: Mr. Jayant K. Mehta, Advocate.

versus

COMMISSIONER OF INCOME TAX-I &ANR
..... Respondents
Through: Mr. Balbir Singh, Sr. Standing Counsel with Shri Abhishek Singh Baghel, Adv.

CORAM:
MR. JUSTICE S. RAVINDRA BHAT
MR. JUSTICE R.V. EASWAR

R.V. EASWAR, J.

1. In the present proceedings, under Article 226 of the Constitution of India, the petitioner challenges the order dated 26.12.2011 passed by the Assistant Commissioner of Income Tax, Circle 2(1), C.R. Building, I.P. Estate, New Delhi, directing a special audit of its accounts under Section 142(2A) of the Income Tax Act, 1961 for the assessment year 2008-2009.

2. The petitioner is a wholly owned subsidiary of AT&T Communication Services International Inc, USA and was incorporated on 23.04.1996. It is engaged in three business segments, namely; (i) Market research, administrative support and liaison services; (ii) Network connectivity services; and (iii) Managed network services. In respect of the assessment year 2008-2009, the petitioner filed E-return of income declaring a total income of Rs.6,95,74,835/- on 30.09.2008. A notice under Section 143(2) of the Act was issued on 06.08.2009, asking the petitioner to furnish the computation of income and the notes thereto, copies of the balance sheet, profit and loss account and the notes thereto, audit report and also to furnish reasons and make disclosures in support of the various claims made in the return. On 11.01.2010, an enquiry was initiated by issue of notice under Section 142(1) of the Act and several explanations were sought with respect to the return of income and the various claims made by the assessee, and other clarifications. The notice issued on 12.08.20101, again under Section 142(1), called upon the petitioner to furnish the details as per the earlier notice dated 11.01.2010 and also required the petitioner to file the audit report along with balance sheet, profit & loss account and the computation of income. The petitioner was also directed to file the history of its income tax

assessments for the past two years together with copies of the assessment orders. This requirement was complied with by the petitioner on 01.09.2010. On 04.07.2011, the respondent no.2 (Assessing Officer) issued another notice under Section 142(1) calling upon the petitioner to furnish, *inter alia,* copies of the balance sheet, profit & loss account, computation of income and the audit report for the assessment year 2008-2009. Under cover of a letter dated 12.07.2011, the petitioner complied with several requirements as directed by the Assessing Officer by the aforesaid notices. On 14.10.2011, another notice was issued by the Assessing Officer under Section 142(1), calling upon the petitioner to submit information in respect of ten points raised by him which included the names and addresses along with ledger accounts in respect of the advances from customers as per Schedule "1" and details of transactions made with related parties along with the valuation of debtors together with copies of the ledger accounts. By this notice, the respondent called upon the petitioner to submit the information on 18.10.2011. However, since the notice was received by the petitioner only on 18.10.2011, it appears that a request was made to the Assessing Officer to take up the hearing of the case on 19.10.2011, which was accepted by him.

3. On 31.10.2011, the petitioner made detailed submissions in writing before the Assessing Officer through its letter of the said date. This letter referred to the notices issued by the Assessing Officer under Section 142(1) and Section 143(2) as well as the hearing which took place on 19.10.2011. The information was given under various heads. In paragraph 9 of the said letter, the petitioner referred to the request of the Assessing Officer on 19.10.2011 to show cause as to why a special audit under Section 142(2A) of the Act should not be conducted in the petitioner's case having regard to the nature and complexity in the financial statements of the petitioner, and then proceeded to make submissions objecting to the proposal. The objections were made in some detail; predominantly they were based on the premise that there was nothing "complex" or "convoluted" in the financial statements of the petitioner so as to justify the conduct of a special audit, that the financial statements were duly audited by the statutory auditors after verification of the books of account and other relevant documents without any adverse remark or finding and that the transactions entered into by the petitioner and the income and expenditure in relation thereto were in the course of normal business operations. The submissions were sought to be supported by reference to case law.

4. On 28.11.2011, the Assessing Officer, the respondent no.2 herein, submitted the terms of reference for special audit in the case of the petitioner as also in the case of M/s. AT & T Global Network Services Pvt. Ltd., to the Commissioner of Income Tax, Delhi-1, New Delhi (Annexure P-19). The terms of reference were actually submitted by the Additional Commissioner of Income Tax, Range-2, New Delhi through whom it is required to be submitted by the Assessing Officer. So far as the petitioner is concerned, the terms of reference for special audit were as follows:

> *"(**ii) AT&T Communication Services India Pvt. Ltd.**)*
>
> *Related party transactions with AT&T Global Network Services Pvt. Ltd.*
>
> - *The mode of computation has to be worked out.*
>
> ***(Brief facts: As per Annexure "E")***
>
> *Opportunity given to the assessee vide Order Sheet entries dated 19/10.2011 & 14/11/2011 as per provisions of the Act, to explain its position regarding complexities and Special Audit. In response to the same, the assessee's submitted its reply on 31/10/2011 & 16/11/2011 respectively, which is placed on record."*

Annexure "E" enclosed to the aforesaid letter of the Additional CIT was in the following terms:

"***ii) AT&T Communication Services India Pvt. Ltd.***

Brief Facts: (Annexure " E")

The related party transactions relates to sale of Service Income; the Net Income is reported as per debit of costs as per issue involved in the allocation of costs for intergroup charges in the case of its sister concern AT&T Global Network Services Pvt. Ltd. dealt with at point No.1 of this note.

This assessee is an associated party of AT&T Global Network Services Pvt. Ltd. and is engaged in same of line of business, hence, both the assesses are referred together for Special Audit."

5. In addition to the terms of reference made by the Additional CIT on 26.11.2011, which was itself based on the terms of reference for special audit as forwarded by the respondent no.2, which in turn was a joint reference in the case of the petitioner as well as in the case of AT& T Global Network Services Pvt. Ltd., the following terms of reference regarding the special audit in the case of the petitioner were sent by the respondent no.2 to the respondent no.1 through proper channel. In this letter, the respondent no.2 stipulated the following terms of reference in the petitioner's case as under:

" 1. The assessee has shown revenue/income of Rs.16,39,22,134/-, Rs,1,02,31,081/- and Rs.25,91,859/- as sale of services to group concerns namely, M/s AT&T Communication Services International Inc., USA, M/s AT&T Solutions Inc., USA and M/s AT&T Singapore Pte.

Ltd. respectively. The auditor may identify the method/accounting standard applied for recognition of income on this account and also report on the correctness of the income recognised.

1. *The assessee has claimed expenses of Rs.3,94,60,579/- incurred in foreign currency on salary and other perquisites. The auditor may report whether this expenditure relates to assessee's business and whether this expenses is paid to assessee's employees.*

2. *The assessee has shown purchase of equipment of Rs.2,47,69,200/- in foreign currency. The auditor may identify the income reported by the assessee in respect of this equipment and identify the equipment. The auditor may also report whether any foreign exchange fluctuation has arisen on this transaction and whether it is on a revenue or capital account.*

Yours faithfully,
Sd/-
A.K.Dhir
Asst. Commissioner of Income Tax,
Circle 2(1), New Delhi."

6. On 23.12.2011, the Commissioner of Income Tax, Delhi-1, New Delhi, who is the first respondent herein accorded his approval to the special audit proposed in the case of the petitioner and appointed M/s. T.R. Chaddha, Chartered Accountant, Kuthiala Building, Connaught Place, New Delhi as the special auditors.

7. It is noteworthy that in the approval accorded by the respondent no.1, by letter dated 23.12.2011, there is reference to the terms of reference dated 16.12.2011, sent by the respondent no.2 herein.

8. The contention put forth on behalf of the petitioner against the order for special audit in the petitioner's case is threefold; (i) the books of account were not called for or examined by the Assessing Officer and no special audit can be ordered without examining the books of account of the assessee as without such an examination the Assessing Officer would not be in position to assess the nature and complexity of the accounts; (ii) no show cause notice was issued before ordering a special audit and thus there was a breach of the rules of natural justice and ; (iii) there was complete non-application of mind by the first respondent while according approval to the proposal for special audit in the petitioner's case. In support of this contention, our attention was drawn to the decisions of the Supreme Court in *Rajesh Kumar & Ors. Vs. Dy. CIT (2006) 287 ITR 91 and Sahara India (Firm). Vs. Commissioner Of Income-Tax And Another (2008) 300 ITR 403,* as also the judgment of this Court in *DDA Vs. UOI (2013) 350 ITR 432.*

9. One subsidiary contention raised on behalf of the petitioner was that there was an interpolation in the order sheet relating to the

proceedings before the Assessing Officer on 14.10.2011 and 19.10.2011 so as to make it appear as if there was an examination of the books of account by the Assessing Officer before proposing a special audit. The submission is that there was in fact no examination of the books of account of the petitioner.

10. The learned standing counsel appearing for the revenue submitted that Section 142(2A) refers only to "..............nature and complexity of the accounts of the assessee................" and it does not refer to "books of account", and that the word "accounts" is broader than "books of account" as held by the Supreme Court in *Rajesh Kumar (supra).* He further submitted that the complexity of the accounts would be clear from the information supplied by the petitioner in its letter dated 31.10.2011 (Annexure P-13) written in response to the various notices issued by the Assessing Officer. He pointed out that the Assessing Officer in the terms of reference made vide letter dated 16.11.2011 has recognized the need to identify the method and the accounting standard applied for recognition of income from sale of services to group concerns. Reference is also made to paragraph 2 of the order passed by the respondent no.2 under Section 142(2A), which is the impugned order, in which there is a discussion of the complexities in the accounts

of the assessee including the complexity in the matter of attributing and allocating the costs incurred by the petitioner against three type of telecommunications services rendered by the petitioner which gave rise to its revenues. The discussion also includes the method to be adopted in apportioning the infrastructure costs, last mile charges and the inter group charges against the revenues. According to the learned senior standing counsel, these complexities are sufficient to justify the reference to a special audit. In this behalf reliance was placed on a judgement of this court in *Central Warehousing Cooperation Vs. Secretary, Department of Revenue & Ors. (2005) 277 ITR 452.*

11. The learned standing counsel also pointed out that the special audit is now completed and the audit report is ready with the special auditor. He also pointed out that the other company of the same group, namely, AT&T Global Network Services Ltd., in which case also a special audit was approved, did not object to the same and that as a result of the special audit in that case, substantial tax evasion was detected. So far as the allegation of interpolation in the order sheet entries made on 14.10.2011 and 19.10.2011 is concerned, the learned standing counsel pointed out that by the notice dated 14.10.2011 issued under Section 142(1) of the Act, the respondent no.2 had inter alia called for

the ledger accounts relating to the advances received from customers and those relating to the debtors and related parties and it was these ledger accounts, which were subjected to examination by the A.O. on 19.10.2011. He denied that there was any interpolation in the order sheet entries.

12. We have carefully considered the material on record in the light of the rival submissions, but find no merit in the writ petition.

13. So far as the contention that there was no valid show cause notice issued by the A.O. under Section 142(2A) is concerned, we find no merit in the same. As already pointed out, even in the petitioner's letter dated 31.10.2011, addressed to the respondent in response to various notices issued by the latter and with reference to the subsequent discussions held in the course of the hearing which took place on 19.10.2011, the petitioner has submitted an elaborate reply in paragraph 9 of the letter under the caption "show cause as to why special audit under Section 142(2A) of the Act should not be conducted in the instant case". This paragraph clearly refers to the request made by the respondent on 19.10.2011 to the petitioner to show cause as to why special audit should not be conducted because of the nature and complexity in the financial statements. The letter then proceeds to elaborately raise objections to the

show cause notice, supported by case law. The objections run into more than five pages. The petitioner in these objections has harped that there was no complexity in its accounts and that the provisions of Section 142(2A) not only require complexity in the accounts, but also require that there must be some prejudice to the interests of the revenue. The petitioner also objected to the show cause notice on the ground that application of mind is required by the tax officer in order to reach an objective satisfaction and the requirement of Instruction No. 1076 dated 12.07.1997 issued by the CBDT was quoted in the letter. In the light of these detailed objections it is ideal on the part of the petitioner to contend that no show cause notice was issued by the A.O. Section 142(2A), before insertion of the first proviso by the Finance Act, 2007, w.e.f. 1.6.2007, did not contemplate any show cause notice. Even so the Supreme Court in the case of Rajesh Kumar (supra) held that since an order directing special audit entails civil consequences, the principles of natural justice in the form of hearing have to be complied with, though the hearing need not be elaborate. It was also held that the notice to show cause may contain the approval issues that the A.O. thinks to be necessary and need not be elaborate or detailed ones. This view was affirmed by the larger Bench of the Supreme Court in *Sahara India*

(Firm) Vs. CIT (supra). The requirement of the first proviso that there should be adherence to the rules of natural justice and that the assessee should be given an opportunity of being heard before issuing a direction for special audit is satisfied in the present case. The respondent no.2 did require the petitioner to show cause as to why a special audit should not be directed in this case on 19.10.2011; the show cause notice was replied to by the petitioner by a letter dated 31.10.2011. The contention of the petitioner that no show cause notice was issued therefore fails.

14. The next contention to the effect that the books of account were not called for and examined by the A.O. and therefore the direction for special audit is bad in law is also without merit. As already pointed out while referring to the contention of the learned standing counsel for the Income Tax Department, sub-section (2A) of Section 142 does not require the "books of account" to be examined by the A.O. It empowers the A.O., with the previous approval of the Chief Commissioner or Commissioner of Income Tax, to direct the assessee to get the accounts audited if he is of the opinion that it is necessary to do so " *having regard to the nature and complexity of the accounts of the assessee and the interests of the revenue.......".* It has been held by a Division Bench of this Court in *Rajesh Kumar, Prop. Surya Trading Vs. Dy.CIT (2005)*

275 ITR 641, that the expression "accounts" used in the section does not refer merely to "books of account" of the assessee; it could include the books of account, balance sheets and all other records which are available to the A.O. during the assessment proceedings. It refers to the other records available with the A.O. not only in the course of the assessment proceedings but also at any stage subsequent thereto. It was held that the expression "accounts" cannot be confined to books of account as submitted by the assessee, as it would amount to giving an interpretation which completely defeats the very object of the section. It was further held that the fact that the accounts of the assessee are subject to audit under some other statute is also no ground to hold that in such a case the A.O. cannot direct a special audit. It was observed that in addition to the books of account, the A.O. may also take into consideration such other documents related thereto and which would be part of the assessment proceedings. This judgment was followed by another Division Bench of this court in Central Warehousing Corporation (supra). In the light of these authorities, it is not possible to accept the contention that the A.O. cannot direct a special audit unless he examines the books of account.

15. In the case before us the A.O. has taken the view that there is complexity in the accounts of the assessee. He has referred to the three segments or sources of revenue of the petitioner and has held that it is required to identify the method and the relevant accounting standard applicable for recognition of income from these revenues and also to ascertain the correctness of the income recognized. Paragraph 2 of the order passed under Section 142(2A) on 26.12.2011 contains a detailed discussion as to the complexity of the accounts. The profit and loss account, balance sheet and the computation of the income were before the A.O. It can hardly be disputed that the profit and loss account and the balance sheet fit the description of " accounts". The complexity arising out of such accounts is the difficulty in allocating the expenses incurred by the petitioner against the three segments of revenues namely; (i) market research, administrative support and liaison services; (ii) network connectivity services and (iii) managed network services. The A.O. further proceeds to state in the impugned order that the allocation of costs/expenses impacts the profit and loss account (and the ultimate profit figure) and the method and the basis for such allocation is required to be verified and examined by the special auditor. The other complexity adverted to by the respondent is the plea taken by the

petitioner that the overseas payments cannot be characterized as fees for technical services but represented purchase price of goods and services and therefore there was no obligation on its part to deduct tax under Section 195. Yet one more complexity is the nature of the other costs debited in the profit and loss account which include infrastructure costs, last mile charges and inter group charges. The precise nature of these costs is required to be ascertained not only from the legal aspect but also from the accounting aspect, to determine the applicability of Section 40(a)(ia). One more important issue which according the A.O. is quite complex is the "last mile charges". Noting that this is a heavily capital intensive project and the capitalised infrastructure is eligible for depreciation, the respondent has observed that the assessee has deducted the entire last mile charges from the services revenue thereby nullifying any income on this score. According to him the inclusion of the last mile charges in the profit and loss account as a debit, when the capitalised infrastructure cost is eligible also to depreciation, may amount to double deduction. Whether this would amount to double deduction is an aspect which the special audit was required to examined.

16. The question whether the accounts and the related documents and records available with the A.O. present complexity is essentially to be

decided by the A.O. and in this area the power of the court to intrude should necessarily be used sparingly. It is the A.O. who has to complete the assessment. It is he who has to understand and appreciate the accounts. If he finds that the accounts are complex, the court normally will not interfere under Article 226. The power of the court to control the discretion of the A.O. in this field is limited only to examine whether his discretion to refer the accounts for special audit was exercised objectively, as far as the accounts, records, documents and other material present before the A.O. would permit. There must be valid material before the A.O. from which he apprehends that there is complexity. As to what material would make the accounts complex is essentially for the A.O. to determine and unless his decision can be attacked on the ground of perversity or absolute arbitrariness or mala fide, it should not be interfered with. In the present case we are satisfied that the accounts including the documents, records and other material before the A.O. did make the issues for his decision complex requiring a special audit. We are accordingly not inclined to accept the contention of the assessee to the contrary.

17. The other contention is that there was non-application of mind by the respondent no.1 while according his approval to the proposal for

special audit. We do not think that this contention is justified at all. The terms of reference sent by the respondent no.2 were before him. There is no requirement that the approving authority has to record elaborate reasons for approval. Of course, approval cannot be mechanical. We find that the approval was forwarded through the Additional CIT, Range-2, New Delhi, under cover of letter dated 28.11.2011. In this letter there is also a reference to the related parties' transaction and to the assessee's detailed reply dated 31.10.2011. The CIT had before him the views of the respondent no.2 as also those of the petitioner as to what it had to say in reply. The approval was accorded by the CIT on 23.12.2011. It cannot, therefore, be said that the CIT did not apply his mind to the proposal for special audit. The contention of the petitioner to the contrary is not accepted.

18. In the course of the arguments it was submitted on behalf of the petitioner that the assessing officer referred the matter to the Transfer Pricing Officer under Section 92 CA of the Act on which the latter did make an addition of Rs.1.53 crores on account of transactions with the petitioner's associated enterprises and it was at that stage the assessing officer made a reference to special audit; the suggestion was that the exercise was uncalled for since the direction of the TPO was binding on

the AO in any case. Statutorily, the AO is empowered to refer the accounts to the special auditor "at any stage of the proceedings" – S.142(2A); there is no bar, and there is nothing in the sub-section which makes its provisions subject to the powers of the TPO. The reference to special audit cannot be held to be contrary to law on that score.

19. In the view we have taken, we do not consider it necessary to examine the contention of the petitioner based on alleged interpolation of entries in the order sheet on 14.10.2011 and 19.10.2011.

20. In the result the writ petition and all connected applications are dismissed with no order as to costs.

(R.V. EASWAR)
JUDGE

(S. RAVINDRA BHAT)
JUDGE

FEBRUARY 21, 2014
mg