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

\+ ITA 365/2018

Date of decision: 29th November, 2018

PR. COMMISSIONER OF INCOME TAX -2..... Appellant

Through: Mr.Asheesh Jain, Senior Standing Counsel for the Income Tax Department

versus

CINCOM SYSTEMS INDIA PVT. LTD. ..... Respondent

Through: Mr.Kislaya Parashar and Mr.Umang Luthra, Advocates for the respondent

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE ANUP JAIRAM BHAMBHANI

SANJIV KHANNA, J. (ORAL):

Present appeal under Section 260-A of the Income-tax Act, 1961 ('Act" for short) in the case of M/s. Cincom Systems India Pvt. Ltd. is directed against the order dated 16th June, 2017 passed by the Income-tax Appellate Tribunal ('Tribunal' for short) and pertains to the assessment year 2008-09.

2. The respondent-assessee, a company, was engaged in twin business of development and support of computer software of the parent company; and import and marketing of computer software and supplying the same to the end user. For the assessment year they had filed the return declaring income of Rs.1,12,773/- under the normal provisions and Rs.26,34,646/- under Section 115 JB of the Act.

3. The respondent assessee had two units: One unit was located in a

non-STPI zone and hence its income was taxable. The other unit was located in a STPI zone in Gurgaon and its income was exempted under Section 10-A of the Act. The STPI unit was engaged in the business of development and support of its parent company in US/sister concerns worldwide as well as their customers. Separate Books of accounts were maintained for the exempted and non-exempted units.

4. The respondent-assessee had declared exempt income of Rs. 1,48,89,090/- from the business operations of the STPI unit eligible under Section 10A of the Act. The Assessing Officer, though unable to point out any defect, deficiency or wrong entry in the books for the exempt and non-exempt unit, drew a table of income earned and expenses incurred under different heads as per the books relatable to the exempt and non-exempt unit. He observed that there was substantial difference between the turnover and the expenses in the exempt and non-exempt unit, though they were operating with same infrastructure under the same management. The net profit of the software division, which was exempt, was 15.63 per cent. The net profit in the unallocated segment was a loss of 11.20 per cent. Net profit was 1.07 percent. The Assessing Officer for this reason held that the respondent-assessee had shifted huge expenses to the unallocated segment. On the said assumption the Assessing Officer inferred that the expenses claimed as personnel expenses and operative, administrative and other expenses relate to software development unit i.e. the exempt unit. The claim of depreciation in the ratio of 50:50, he observed, appeared to be disproportionate and without cogent basis. Computer, office equipment, furniture and fixtures, vehicles etc. must have been used for software development activity and, therefore, should be suitably accounted in both the eligible and non-eligible units. Bad debt of Rs.1,23,80,391/- written off

in the unallocated segment should have been allocated to exempt segment. The Assessing Officer noticed that the Transfer Pricing Officer had accepted the price charged as Arms Length Price, but this he observed did not matter for the Transfer Pricing Officer had not verified whether the expenditure claimed was correct. Recording the aforesaid findings, the Assessing Officer disallowed the entire claim of Rs.1,48,89,090/- under section 10A of the Act.

5. The aforesaid addition was deleted by the Commissioner of Income Tax (Appeals), who observed that the respondent-assessee was maintaining separate accounts for STPI and non-STPI unit, and the Assessing Officer had not been able to point out a single entry in respect of STPI unit which was found to be dubious or relatable to non-STPI unit. The findings recorded by the Commissioner of Income Tax (Appeals) read:-

> "4. **Decision in Appeal-** I have carefully considered the submission of the appellant. I have also gone through the relevant assessment order passed in this case.
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> 4.1. So far as the first two grounds of appeal is concerned, the assessee company during the year has been engaged in the business of import and marketing of software & supplying the same to the end user by development and support of computer software for its parent company in Maurities i.e M/s Cincom System (Maurities) (P) Ltd, which in turn is a subsidiary of M/s Cincom International Operations Inc., USA, worldwide as well as to their other customers. It has provided software solutions services to client across the world, that helps its clients to create, manage and grow relationship with their customers through adoptive e-business information system, implementation & customization services and a comprehensive end user training & worldwide 24x7,

support services on all the products it sells. The assessee is also eligible for exemption u/s 10A of the Act, as a STPI Unit & during the year under consideration, it had claimed u/s 10A of the Act of Rs.1,48,89,090/-. The appellant company is also maintaining regular books of accounts for its STPI unit & non STPI Units. However, the AO denied the deduction u/s 10A of the of Rs.1,48,89,090/- to the appellant company by reallocating the expenses to STPI unit & not adjusting Brought Forward unabsorbed depreciation of Rs.35,15,609/-, against the current years income. The AO therefore, discarded the segment wise Profit & Loss Account of the assessee for the year ended 31.03.2008 (AY 2008-09), based on separate sets of books of account maintained by the assessee for its STPI & Non STPI units (marketing & Unallocated), by interalia, observing that there is a huge difference between turnover and expenses under various heads claimed by the assessee for its eligible & ineligible units, though operating under same infrastructure and management. The assessee had shown overall 1.07% Net Profit Rate based on its consolidated profit & Loss Account. However, the net Profit of the Software Division was 15.63% while in the unallocated segment, there was a Net Loss of 11.20% & therefore he came to the conclusion on analysis of facts and details that the assessee has shifted huge expenses to the unallocated segment. Evan, the Depreciation claim of 50:50 ratio also appeared to him to be disproportionate and without any cogent basis. As regard Bad Debts claim also, as written off & reflected in the unallocated segment, the AO observed that the said amount represented the Date of the previous years, pertaining to its software operations and therefore, bad debt should have been allocated to the software development segments. Therefore, the AO took recourse to provisions of section 10A(7) r.w.s 80IA(10) of the Act.

4.1.2 Section 10A of the Act provides' for a deduction of profits derived from export orientated units (EOUs) set up in free trade zones (FTZs), electronic hardware technology parks (EHTPs), software technology parks (STPs) or Special Economic Zones (SOZs). The deduction is allowable in respect of profits and gains derived by an undertaking from the export of articles, things or computer software. The deduction is available for a period of 10 consecutive years (not beyond F.Y. 10-11) beginning with the year in which the undertaking begins to manufacture or produce articles or things or computer software. Further, it should not be formed by the splitting up or reconstruction of a business already in existence. However, deduction is provided if the unit is formed as a result of reestablishment, reconstruction or revival by the assessee of the business of the undertaking as is referred to & satisfying the conditions in Section 33B of the Act. It should also not be formed by the transfer of machinery or plant, previously used for any purpose, to a new business. Exceptions, however, inter alia, provide that deduction u/s 10A will be available, if the total value of second hand machinery or plant transferred to the new undertaking does not exceed 20% of the total value of machinery or plant used in such unit. Sub section (3) of section 10A provides that the sale proceeds of articles or things or computer software etc exported out of India should be received in, or brought into, India by the assessee in convertible foreign exchange, within a period of six months from the end of the previous year or within such further period as the Competent Authority (RBI) allow in this behalf. It is also conditioned that the exemption should not be admissible for any assessment year i.e. 2001-02 or thereafter, unless the assessee furnishes in the prescribed form (Form No. 56F), along with the return of income, the report of a Chartered Accountant certifying that the

deduction has been correctly claimed in accordance with the provisions of Section 10A.

4.1.3 While it is true that there did exist a close connection between the assessee company carrying on eligible business to which section 80IA(10) applies and its ineligible business, the other requirements such as the nature of arrangement & the manner of rejection of the profit margin in effect, due to export sales as inflated profits attributable to export activities, have not been disclosed by the AO. The AO stated that the course of business appears to be so arranged regarding the business transaction between two units e.g. eligible & ineligible of the assessee, that it has shifted huge expenses to the unallocated segment arbitrarily to hoodwink the revenue, which might be expected to arise in the business undertaking claiming exemption u/s 10A of the Act on one hand & also by claiming huge loss in the eligible unit for the purpose of carry forward & set off the loses in future years against the positive income, when tax holiday period expires. However, the word 'appears' cannot be taken in isolation de hors the qualifying words 'so arranged' with the business, more than the ordinary profits in the eligible business. While on the first aspect, there is not much dispute, the second requirement, viz, it is a course of business so arranged as to result in an inflated profit for the eligible business by way of shifting huge expenses to unallocated unit, is not forthcoming from the order of the AO. The appellant is maintaining separate books of account for its STPI & Domestic business & has recorded all the corresponding expenditure as well as income/receipts. The Assessing Officer was only required to find out the correctness of the books of accounts as regards the allocation of common expenditure for export & domestic business & complete the assessment accordingly. The Assessing Officer has in turn rejected the assessee's books

of account in effect & in essence & resorted to estimation i.e. apportionment of expenditure claimed under the head unallocated segment in the ratio of 90:10 between software development activities & unallocated segment, thereby treating the same, as attributable in that ratio in 'eligible unit' & 'ineligible unit', on purely surmises, in a suspicious & conjecture manner, without any evidence with him to suspect the books of account. When there are no mistakes in the books of account and books of account are in verifiable manner, the AO cannot reject the books of account and resort to best judgement assessment. Therefore, the AO is not correct in reallocating the unallocated expenditure on 90:10 basis. There be no material to indicate that the course of business had been so arranged as to inflate profits in the eligible business i.e. to show a higher profit in the eligible business i.e. export unit. The AO is directed to allow the expenditure as per the books of account maintained by the assessee & to recompute the deduction u/s 10A of the Act subject to its eligibility as commented upon in the subsequent para, in the appellate order, keeping also in view the principles of consistency & the method of accounting followed by the assessee, wherein no deviation noted vis-a-vis method accounting employed in the immediately preceding previous year.

5.1.4. However, the appellant is still not eligible for deduction u/s 10A of the Act as it has credited an amount of Rs. 16.59 crores in its Profit & Loss Account that was not earned by the assessee by any manufacturing or production activity or export of software, the proceeds there of are receivable or received in convertible foreign exchange as provided under section 10A of the Act i.e. the amount is not earned by the assessee by way of its main activities i.e. software development activity but the same is a deemed income arose to the assessee by way of remission or cessation of liability u/s 41(1) of the Act, by way of writing back the liability, no longer needed. Further against the income, not otherwise eligible u/s 10A, only the corresponding inventory amounting to

> Rs.13.74 crore was written off. Moreover, on other income of Interest on Fixed Deposits etc, the same is required to be charged to the Income Tax, under the Head 'Income from Other Sources' & are also not eligible as they are not receivable or received in convertible foreign exchange. Therefore, the appellant is denied the benefit of exemption u/s 10A of the Act but on separate reasons.
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> This disposes of the first two grounds of appeal, in effect & essence and against the appellant."

6. The Tribunal, on an appeal preferred by the Revenue, has partly accepted the same by correcting two factual inaccuracies in the order of the Commissioner of Income Tax (Appeals), and thereby excluded Rs.16,59,42,925/- and also Rs.36,28,383/- from the income exempt under Section 10A of the Act. However, on the substantive aspect and reasoning, the Tribunal agreed with the findings recorded by the Commissioner of Income Tax (Appeals) that the Assessing Officer was not justified in transposing expenditure from non-exempt to exempt unit on the general assumption that net profit in distinct lines cannot be different and must be the same. Separate and segregated accounts cannot be rejected on the ground that the profit margin of the STPI unit was higher than the profit margin of the non-STPI unit, without pointing out any discrepancy, error or mistake in the accounts.

7. The findings are unchallengeable. The Assessing Officer was unable to point out any defects, deficiencies or wrong entry in the books of accounts for the exempt and non-exempt unit. The Act does not prohibit an assessee from having non-STPI unit and STPI unit. This is not the case and the allegation made by the Revenue. It is also not the case and allegation of the Revenue that the business or orders undertaken by the non-STPI unit

were transferred to the STPI unit. The two lines of business were separate. The finding that the two lines of business were separate has not been questioned. Expenditure declared and disclosed as incurred for non-exempt unit cannot be treated and transposed as expenditure incurred on exempt unit, on assumptions and surmises by referring to difference in turnover, expenses and net profit rate of exempt and non-exempt units. This cannot justify the Assessing Officer's direction to shift 90% of the expenditure from the non-exempt unit and treat it as expenditure of the exempt unit, thereby reducing the profit in the STPI unit. Inference and deduction solely based and predicated on net profit rate is nothing but a surmise and conjecture. Under Section 144 of the Act, book results cannot be rejected only on the ground of decrease or difference in gross profit rate compared to other years or another assessee. Neither can the book results be rejected for the reason that gross or net profit rates in the two lines of business are different. The difference can be the starting point of investigation and verification but not the essence to reject the book results and make best judgment assessment.

8. In view of the aforesaid discussion, no substantial question of law arises for consideration in the present appeal and the same is dismissed without any order as to costs.

SANJIV KHANNA, J

ANUP JAIRAM BHAMBHANI, J

NOVEMBER 29, 2018
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