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

% Date of decision: 07.03.2022

\+ **W.P.(C) 8411/2020 & CM No.38352/2021**

ERICSSON INDIA PRIVATE LIMITED ..... Petitioner

Through : Mr Vishal Kalra and Mr S.S. Tomar, Advs.

Versus

ASSISTANT COMMISSIONER OF INCOME TAX, NEW DELHI & ANR. ..... Respondents

Through : Mr Shlok Chandra and Mr Ruchir Bhatia, Advs.

CORAM:
HON'BLE MR JUSTICE RAJIV SHAKDHER
HON'BLE MR JUSTICE JASMEET SINGH

[Physical Hearing/Hybrid Hearing (as per request)]

RAJIV SHAKDHER, J. (ORAL):

1. This is a writ petition directed against the order dated 28.04.2020, passed by the respondents-revenue under Section 241A of the Income Tax Act, 1961 [in short 'the Act'], concerning the assessment year (AY) 2018-2019.

2. This is a second round of litigation for the petitioner-assessee.

3. In the first round, the petitioner-assessee approached this Court with a similar grievance i.e., that its refunds for AYs 2016-2017, 2017-2018 and 2018-2019 had been withheld for legal cause.

3.1. To agitate its grievance, the petitioner-assessee had filed three writ petitions qua each of the aforementioned assessment years i.e. W.P.(C) No.10373/2019; W.P.(C) No.10374/2019 and W.P.(C) No.10375/2019.

3.2. These writ petitions were disposed of by a coordinate bench of this Court, via a common judgment dated 18.02.2020. The Court, while disposing of the writ petitions, had issued the following operative directions:

> "*19. In absence of any cogent reasons justifying withholding of the refund due to the petitioner under Section 143(1) for AY 2017-18, 2018-19, we find that the proposal as well as the approval granted by Principal Commissioner of Income Tax lacks consideration of the relevant and germane conditions.* ***We, accordingly, set aside the order and direct the respondents to undertake the exercise afresh and pass an order under Section 241A. We, therefore, grant six weeks' time to the respondents to consider the aspect whether the amount found due to be refunded, or any part thereof, is liable to be withheld under Section 241A. While doing so, the Assessing Officer shall, firstly, with reasons, make a prima facie estimation of the probability that additions would be made in the Scrutiny Assessment Proceedings; secondly, he shall make an estimation of the quantum of additions/disallowances, if any, that may be made to the income returned, and the likely tax effect that such additions/disallowances may have, thirdly; he, should consider the financials, and financial standing of the petitioner with regard to its ability to meet and service any demand for the tax that may be raised as a result of the Scrutiny Proceedings; and, also take into consideration such other factors eg. past demands, any outstanding litigation and the past conduct of the assessee etc.All the aforesaid aspects should be examined to ascertain if the payment of the refund, or any, part thereof, are likely to have adverse affect on the Revenue. The order must reflect due application of mind of the Assessing Officer while making a proposal whether, or not, to withhold any part of the refund amount. Such a proposal should be examined by the Principal Commissioner of lncome Tax with due application of mind on all the aforesaid aspects. The entire consideration, with the approval of the Principal Commissioner of Income Tax to the withholding of the refund amount, or any part thereof, should be completed within six weeks from today, failing which, we direct the without awaiting any further***

orders, the respondents shall transmit the amount of Rs. 48,361,57,240/- (for A Y 2017-18), Rs. 421,18,02,760/- (for AY 2016-17) and Rs. 349,41,45,020/- (for AY 2018-19) with interest to the petitioner. In the eventuality of the respondents recording any reasons for withholding a part of, or the entire amount due for refund to the petitioner under Section 143(1), the reasons thereof as approved by the Principal Commissioner of Income Tax shall be provided to the petitioner forthwith. It shall be open to the petitioner to take remedial steps in respect of any orders for withholding of refund that may be passed. *Needless to state that the reasons recorded for withholding of refund under section 241A. would only amount to a tentative view and would not come in the way of the Assessing Officer to frame the assessment under section 143(3) of the Act."*[Emphasis is ours.]

3.3. In sum, via the judgment dated 18.02.2020, this Court granted six weeks to the respondents- revenue to pass a fresh order bearing in mind the following :

(i) Probable additions that may have to be made in the scrutiny assessment proceeding, based on a *prima facie* estimation. In this behalf, reasons were required to be furnished.

(ii) Quantum of additions and disallowances, if any, on the basis of estimations and their likely tax impact.

(iii) The financial wherewithal of the petitioner-assessee and its ability to meet and service any demand for tax that may be raised against it.

3.4 For the aforesaid purpose, the Assessing Officer [ÁO] was required to take into account, illustratively, past demands, pending litigation and the past conduct of the assessee.

3.5. It is not in dispute that after the judgment dated 18.02.2020 was rendered by this Court, the respondents-revenue refunded Rs.561.72 crores (including interest) to the petitioner-assessee on 02.05.2020, in respect of

AY 2017-2018.

3.6. Insofar as the AY in issue is concerned i.e., AY 2018-2019, a fresh order was passed, as noticed above, i.e. order dated 28.04.2020. Via this order, the respondents-revenue have withheld Rs.349,41,45,020/-. The foundation of this order is the view of the concerned AO that the petitioner-assessee may have to bear tax liability in the range of Rs.500 crores as and when an assessment order is framed qua AY 2018-2019.

4. Mr Vishal Kalra, who appears on behalf of the petitioner-assessee, says that the impugned order dated 28.04.2020, passed by the AO, is erroneous and unsustainable in law for the following reasons :

(i) The AO has failed to take into account the parameters which were laid down by this Court, while passing the above-mentioned judgment dated 18.02.2020.

(ii) The estimation of tax liability is not founded on cogent reasons and does not, *inter alia*, take into account either the history of the petitioner-assessee or its financial wherewithal.

5. Messrs Ruchir Bhatia and Shlok Chandra, learned standing counsel for respondents-revenue, on the other hand, rely upon the impugned order to defend their stand.

5.1. According to them, the impugned order adverts to the reasons as to why the AO has concluded that there is a likelihood of the petitioner-assessee having to bear, approximately, tax liability in the range of Rs.500 crores.

6. We have heard the learned counsel for the parties and examined the record.

6.1. A perusal of the impugned order shows that the AO's conclusion is

founded on his view that he would possibly have to make adjustments under the following three heads, leading to a likelihood of the petitioner-assessee being mulcted with a tax liability of nearly Rs 500 crores.

6.2 These three heads are:

(i) Addition on account of arm's length price ['ALP'] adjustments;

(ii) Addition on account of disallowance of foreign exchange loss on account of 'Marked to Market Losses; and

(iii) Addition on account of unearned revenue.

7. It is pertinent to note that insofar as the first head is concerned i.e., addition on account of ALP Adjustment, in the petitioner's-assessee's case the same cannot give rise to any liability as the petitioner-assessee has executed an Advance Pricing Agreement ['APA']. As a matter of fact, the APA was executed by the petitioner-assessee on 04.12.2019.

7.1. Our attention was drawn by Mr Kalra to Annexure A-1, appended the an interlocutory application filed by him i.e., CM No.38352/2021, which is a copy of the order passed by the Transfer Pricing Officer (TPO) u/s 92CA(3) of the Act, concerning the AY in issue i.e., AY 2018-2019. The operative part of the said order, which is dated 26.07.2021, reads thus:

> "*5. Accordingly, No adverse inference is drawn in respect of arm's length price of the International transaction for F.Y. 2017-2018 pertaining to A.Y. 2018-2019.*"

7.2. Therefore, any likelihood of tax liability on this score seems unlikely.

8. This brings us to the second head i.e., disallowance of foreign exchange losses on account of "Marked to market losses".

8.1. A careful perusal of the impugned order shows that the AO has, in fact, not made any estimation as to what is the foreign exchange fluctuation

loss (which includes Marked to market loss), that he is likely to disallow. The only aspect that the AO has touched upon to justify the tax liability under this head is that an addition of Rs. 11 crores was made in AY 2016-2017, concerning Marked to market losses.

8.2. After adverting to this aspect, the AO has let the issue hang in the air as he has not gone on to indicate an estimated amount which he is likely to disallow in AY 2018-2019 on account of foreign exchange fluctuation loss, which includes Marked to market losses, and, therefore, the additional tax burden it would result in imposing on the petitioner–assessee under this head.

9. This brings us to the third head. This is one head where, according to the AO, there is likely to be a humongous addition to the taxable income of the petitioner–assessee.

9.1. Briefly, it is the AO's estimation that on account of unearned revenue and advances from customers in FY 2017-2018 [corresponding to AY 2018-2019], the likely addition would be about Rs. 1050 crores. This addition is based on the AO's estimation that the petitioner-assessee would collect Rs. 1,111.50 crores as unearned revenue, and likewise it would receive Rs. 984.30 crores as advances from customers in FY 2017-2018 [i.e., AY 2018-2019].

9.2. Mr. Kalra has drawn our attention to Annexure-9, which is the order of the Dispute Resolution Panel [in short "DRP"] dated 02.08.2011 concerning AY 2007-2008, to demonstrate that the petitioner–assessee has been consistently following an accounting policy of showing unearned revenue in its balance sheet as current liability and offering the same for tax in the year in which either service is rendered and/or goods are sold. In

particular, Mr Kalra drew our attention to the following observations made by the DRP:

> "*4.1 Ground No.1: Untamed income of Rs. 5,60,34,756/-*
> *4.1.1 The assessee has objected to the proposed addition of Rs. 5,60,34,756/- being unearned income shown under the head current liabilities. The assessee states that no opportunity was given to it to explain its stand. Accordingly, detailed facts could not be submitted to the AO. Nevertheless, the assessee has explained how this amount was not taxable in this AY. The assessee has offered this amount for taxation in the immediately succeeding year i.e. AY 2008-09. The assessee explained that as per its regular method of accounting it is offering for taxation a part of its AMC income spread over two accounting years. It stated that as per its accounting policy it recognizes unearned revenue each year and offers the same in the year in which the services are rendered. It also stated that the accounting policy of the company is in accordance with the Accounting Standard 9 issued by the ICAI.*
> *4.1.2 The DRP has considered the matter. As additional evidence was submitted by the assessee on this point an opportunity was given to the ACIT, Cir 10(1), New Delhi to submit his comments, however inspite of reminders no comments were submitted.* ***It is seen that the assessee is regularly following the accounting method as described above. It is seen that it has offered for taxation unearned income for taxation regularly in the manner described above. The financials for the years ending on 31.03.2005 and 31.03.2008 also show that unearned I income had been recognized in the past as well as in the subsequent years. It shows that the accounting policy of recognizing unearned revenue each year and offering the same in the year in which services are rendered has been regularly followed by the assessee.*** *As per the chart submitted by the assessee it has offered unearned income of Rs. 1,65,47,889/- this year, and Rs. 560034756/- has I been offered in AY 2008-09. This similar practice has been followed by the assessee right from AY 2003~04 till 2011-12. This being the case, the DRP is of the*

> *opinion that keeping in view the accounting policy being followed regularly, the addition made of Rs. 5,60,34,756/- is unjustified.Therefore the assessee's objection on this point is accepted and addition is deleted."* [Emphasis is ours]

9.3. A close scrutiny of the observations made by the DRP in the aforementioned order would show that the assessee has been following a consistent accounting policy of recognizing unearned revenue in each financial year, and offering it for tax as and when services are rendered and/or goods are sold. This accounting policy, as per the aforementioned order of the DRP, was followed consistently by the petitioner-assessee between AY 2003-04 and AY 2011-12.

9.4. We are told [and something which is not disputed by Mr Bhatia and Mr Chandra] that the order dated 02.08.2011 concerning AY 2007-08, has not been disturbed.

9.5. In this behalf, we may profitably quote the following observations of the Supreme Court made in the judgement rendered in ***CIT v. Woodward Governor India (P) Ltd.***, (2009) 13 SCC 1 :

> "**32.** In the light of what is stated hereinabove, it is clear that profits and gains of the previous year are required to be computed in accordance with the relevant accounting standard. It is important to bear in mind that the basis on which stock-in-trade is valued is part of the method of accounting.
>
> **33.** It is well established, that, on general principles of commercial accounting, in the P&L account, the values of the stock-in-trade at the beginning and at the end of the accounting year should be entered at cost or market value, whichever is lower—the market value being ascertained as on the last date of the accounting year and not as on any intermediate date between the commencement and the closing of the year, failing which it would not be possible to ascertain the true and correct state of affairs. No gain or profit can arise until a balance is struck between the cost of acquisition and the proceeds of sale. The

word "profit" implies a comparison between the state of business at two specific dates, usually separated by an interval of twelve months. Stock-in-trade is an asset. It is a trading asset. Therefore, the concept of profits and gains made by business during the year can only materialise when a comparison of the assets of the business at two different dates is taken into account.

34. Section 145(1) enacts that for the purpose of Section 28 and Section 56 *alone*, income, profits and gains must be computed in accordance with the method of accounting regularly employed by the assessee. In this case, we are concerned with Section 28. Therefore, Section 145(1) is attracted to the facts of the present case. Under the mercantile system of accounting, what is due is brought into credit before it is actually received; it brings into debit an expenditure for which a legal liability has been incurred before it is actually disbursed (see judgment of this Court in *United Commercial Bank* v. *CIT* [(1999) 8 SCC 338 : (1999) 240 ITR 355]) Therefore, the accounting method followed by an assessee continuously for a given period of time needs to be presumed to be correct till the AO comes to the conclusion for reasons to be given that the system does not reflect true and correct profits. As stated, there is no finding given by the AO on the correctness of the accounting standard followed by the assessee(s) in this batch of civil appeals.

35. Having come to the conclusion that valuation is a part of the accounting system and having come to the conclusion that business losses are deductible under Section 37(1) on the basis of ordinary principles of commercial accounting and having come to the conclusion that the Central Government has made Accounting Standard 11 mandatory, we are now required to examine the said accounting standard (AS).

36. AS 11 deals with giving of accounting treatment for the *effects of changes* in foreign exchange rates. AS 11 deals with effects of exchange differences. Under Para 2, reporting currency is defined to mean the currency used in presenting the financial statements. Similarly, the words "monetary items" are defined to mean money held and assets and liabilities to be received or *paid* in fixed amounts e.g. cash, receivables and payables. The word "paid" is defined under Section 43(2). This has been discussed earlier. Similarly, it is important to note that foreign currency notes, balance in bank

accounts denominated in a foreign currency, and receivables/payables and loans denominated in a foreign currency as well as sundry creditors are all monetary items which have to be valued at the closing rate under AS 11.

37. Under Para 5 of AS 11, a transaction in a foreign currency has to be recorded in the reporting currency by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency *at the date of the transaction*. This is known as recording of transaction on initial recognition. Para 7 of AS 11 deals with reporting of the *effects of changes* in exchange rates *subsequent to initial recognition*. Para 7(*a*) inter alia states that on each balance sheet date monetary items enumerated above, denominated in a foreign currency should be reported using the closing rate.

38. In case of revenue items falling under Section 37(1), Para 9 of AS 11 which deals with recognition of exchange differences, needs to be considered. Under that Para, exchange differences arising on foreign currency transactions have to be recognised as income or as *expense* in the period in which they arise, except as stated in Para 10 and Para 11 which deal with exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets, which topic falls under Section 43-A of the 1961 Act.

39. At this stage, we are concerned only with Para 9 which deals with revenue items. Para 9 of AS 11 recognises exchange differences as income or expense. In cases where e.g. the rate of dollar rises vis-à-vis the Indian rupee, there is an expense during that period. The important point to be noted is that AS 11 stipulates effect of changes in exchange rate vis-à-vis monetary items denominated in a foreign currency to be taken into account for giving accounting treatment on the balance sheet date. Therefore, an enterprise has to report the outstanding liability relating to import of raw materials using closing rate of exchange. Any difference, loss or gain, arising on conversion of the said liability at the closing rate, should be recognised in the P&L account for the reporting period."

9.5(a) Also see observations made in ***Commissioner of Income Tax-III v. ShyamTelelink Ltd.,*** 2018 SCC OnLine Del 12872 :

"15. **On the question of application of the accounting principles, Section 145 of the Act and mandate of the Companies Act and paragraph 9 of the Accounting Standards, in Dinesh Kumar Goel (supra) it was observed:—**

> **"28. Reading of the aforesaid (AS) 9 makes it clear that revenue is recognized only when the services are actually rendered. If the services are rendered partially, revenue is to be shown proportionate with the degree of completion of the services. This really clinches the issue in favour of the assessee.**
> **29. Though our discussion on the issue is complete, the parting comments need to be made. The receipts relate to the unexecuted packages, which are not shown in the instant year would be shown in the succeeding year.** Rate of tax in respect of companies remains the same in all these years. Therefore, the Revenue does not lose anything, as it would receive the tax on this income in the succeeding year. Still issues are raised and much outcry is made for nothing."

16. Thereafter, the Delhi High Court in Dinesh Kumar Goel (supra) had quoted the following passage from the decision of Bombay High Court in Commissioner of Income Tax v. Nagri Mills Co. Ltd., [1958] 33 ITR 681 (Bom):

> "We have often wondered why the Income tax authorities, in a matter such as this where the deduction is obviously a permissible deduction under the income tax Act, raise disputes as to the year in which the deduction should be allowed. The question as to the year in which a deduction is allowable may be material when the rate of tax chargeable on the assessee in two different years is different; but in the case of income of a company, tax is attracted at a uniform rate, and whether the deduction in respect of bonus was granted in the assessment year 1952-53 or in the assessment year corresponding to the accounting year 1952, that is in the assessment year 1953-54, should be a matter of no consequence to the Department; and one should have thought that the Department would not fritter

away its energies in fighting matters of this kind. But, obviously, judging from the references that come up to us every now and then, the Department appears to delight in raising points of this character which do not affect the taxability of the assessee or the tax that the Department is likely to collect from him whether in one year or the other."

17. In Bilahari Investment (P) Ltd. (supra), the Supreme Court had elucidated that revenue recognition was attainable by several methods of accounting. The same result could be attained by any one of the accounting methods. Completed contract method was one such method. Similarly, percentage of completion method was another such method. Percentage of completion method tries to attain periodic recognition of income in order to reflect current performance. The amount of revenue recognized under this method is determined by reference to the stage of completion of the contract.

18. The appropriation of prepaid amount was contingent upon the respondent-assessee performing its obligation and rendering services to the prepaid customers as per the terms. If the respondent-assessee had failed to perform the services as promised, it would be liable and under an obligation to refund the advance payment received under the ordinary law of contract or special enactments, like the Consumer Protection Act. The aforesaid legal position would meet the argument of the Revenue that the prepaid amount received was not liable to be refunded or repaid, whether or not any services were rendered.

19. In J.K. Industries Ltd. v. Union of India, [2008] 297 ITR 176 (SC) and Commissioner of Income Tax v. Woodward Governor India P. Ltd., [2009] 312 ITR 254 (SC), the Supreme Court has emphasized that the accounting standards as framed and followed by the auditors should be respected, for they provide harmonization of concepts and accounting principles and ensure discipline. Accounting methods followed continuously by the assessee for given period of time would ensure revenue neutrality and reflect true and correct income or profits."[Emphasis is ours.]

9.6. As would be evident upon a perusal of the aforesaid extracts, the court laid emphasis and gave weight to the aspects such as consistent application of accounting policy and the concept of revenue neutrality.

9.7. As would be noticed, in this case as well, it is not as if the petitioner/assessee is not offering unearned revenue for tax; it is only on account of accounting policy followed consistently that unearned revenue is offered for tax in the year in which services are rendered and/or goods are sold. Thus, the transaction, in effect, being revenue neutral, it does not affect the interest of revenue.

10. The upshot of the aforesaid discussion is that the estimation made by the AO that because there is a likelihood of the petitioner–assessee having to bear a tax liability of Rs. 500 crores in AY 2018-19, and, therefore, the refund sought of Rs. 349,41,45,020/- ought to be denied, is not founded on rational and cogent grounds.

10.1. The AO, as rightly argued by Mr. Kalra, has not taken into account the financial wherewithal of the petitioner–assessee. It is the petitioner's–assessee's claim that, at present, its net worth, as on 31.03.2021, is nearly Rs. 1873.80 crores,.

10.2. Besides this, the petitioner has also appended documents with CM 38532/2021 [i.e., Annexures A-3 and A-4] to demonstrate that a cumulative amount of Rs. 214.86 crores, towards refund, is due to the petitioner-assessee for AYs 2002-2003, 2009-2010, 2011-2012, 2012-2013 to 2016-2017 and 2020-2021.

10.2(a) It appears that the petitioner–assessee has escalated the matter concerning the abject failure in not processing its request for refund to the Chairman, Central Board of Direct Taxes, via communication dated

30.09.2021.

10.2(b) None of these aspects are in dispute.

10.3. Therefore, according to us, it is not as if the petitioner–assessee does not have the necessary financial wherewithal to defray the estimated tax liability, if it arises qua the AY in issue i.e., AY 2018-2019.

10.4. Furthermore, in any event, besides the refund that the petitioner–assessee seeks in the present proceedings, there is, as indicated above, an amount equivalent to approximately Rs. 214 crores which is still locked up with the respondent– assessee.

11. We must state that Messrs Bhatia and Chandra have indicated to us that the assessment order for AY 2018-19 is likely to be passed shortly, and in any case no later than 31.03.2021.

12. Given the aforesaid facts and circumstances, in any event, the respondents– revenue are secure, if not for more amount, at least for Rs. 214 crores towards refund, which is the amount that remains locked up; on which, we are told, no decision has been taken by the respondents–revenue as yet.

13. In these circumstances, we are inclined to allow the writ petition.

13.1. It is ordered accordingly.

13.2. The impugned order dated 28.04.2020 is set aside.

13.3. The respondents–revenue will release Rs. 349,41,45,020 crores to the petitioner-assessee i.e., the refund claimed for AY 2018-19.

14. Needless to add that the observations made hereinabove by us were made in the context of examining the tenability of the order passed by the AO u/s 241A of the Act, and can therefore have no impact on the framing of the assessment order for the AY 2018-2019 vis-a-vis the petitioner-

assessee.

15. Consequently, pending application shall stand closed.

RAJIV SHAKDHER, J

JASMEET SINGH, J

MARCH 7, 2022/rb/dm

Click here to check corrigendum, if any