**(2010) 02 DEL CK 0335**

**Delhi High Court**

**Case No:** Income Tax Appeal No''s. 1003, 1028 and 1030 of 2008 and C.O. No''s. 15335, 15664 and 15666 of 2009

| | | |
|---|---|---|
| Commissioner of Income Tax | | APPELLANT |
| | Vs | |
| ECS Ltd. <BR> ECS Ltd. Vs Commissioner of Income Tax | | RESPONDENT |

**Date of Decision:** Feb. 5, 2010

**Acts Referred:**

- Constitution of India, 1950 - Article 14
- Income Tax Act, 1961 - Section 271(1), 271(1B), 274, 275, 80A(2)

**Citation:** (2010) 231 CTR 255 : (2011) 336 ITR 162 : (2010) 194 TAXMAN 311

**Hon'ble Judges:** Siddharth Mridul, J; A.K. Sikri, J

**Bench:** Division Bench

**Advocate:** Prem Lata Bansal, for the Appellant; Ajay Vohra, Kavita Jha, Sriram Krishan and Akansha Aggarwal, for the Respondent

**Judgement**

A.K. Sikri, J.

In these three appeals preferred by the Revenue, we are concerned with the validity of the orders passed by the Tribunal deleting the penalty levied u/s 271(1)(c) of the IT Act (hereinafter referred to as ''the Act'') in respect of asst. yrs. 1994-95, 1995-96 and 1996-97. The reasons for passing penalty orders by the 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 u/s 80O of the Act claimed @ 50 per cent of the net foreign consultancy income. No expenses incurred in India are allocated/apportioned to earning of foreign consultancy income. Section 80O of the Act, as it stood at

material time reads as under:

Section 80O. Deduction in respect of royalties, etc., from certain foreign enterprises.--(1) Where the gross total income of an assessee being an Indian company, or a person (other than a company) who is resident in India includes any income received by the assessee from the Government of a foreign State or foreign enterprise in consideration for the use outside India of any patent, invention, design or registered trademark, 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 per cent of the income received in convertible foreign exchange from rendering technical services outside India and brought into India. The respondent/assessee claimed deduction u/s 80O 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 u/s 80O 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 u/s 80O of the Act claimed by the appellant and deduction allowed under that section by the AO may be tabulated as under:

| Asst. yr. | Foreign consultancy income | Deduction u/s 80O | |
|---|---|---|---|
| | | Claimed by the assessee | Allowed by the AO |
| 1994-95 | Rs. 15,74,543 | Rs. 7,87,272 | Rs. 68,437 |
| 1995-96 | Rs. 38,74.260 | Rs. 19,37,637 | 1,76,630 |
| 1996-97 | Rs. 1,20,92,449 | Rs. 60,46,224 | Rs. 4,49,947 + allowed by Tribunal 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 u/s 80O 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 u/s 271(1)(c) of the Act was not exigible in respect of short allowance of deduction u/s 80O 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 u/s 271(1)(c) of the Act.

(c) The AO having allocated/apportioned Indian expenses on estimate basis, the same could not constitute ground for levying penalty.

5. The Tribunal by a combined order deleted the penalty levied for the asst. yrs. 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 u/s 80O 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 u/s 80O 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 CIT v. Marketing Research Corporation (1987) 61 CTR 204 (Del).

6. The Revenue has come up in appeal against the order of the Tribunal deleting the penalty levied u/s 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 dt. 26th Oct., 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 of the assessee as to whether the issue was debatable at the time of filing of the return and therefore, it was a bona fide belief of the 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 Tribunal was correct in law in deleting the penalty imposed by the AO u/s 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 w.e.f. 1st April, 1989 vide Finance Act, 2008 where Clause (IB) in Explanation to Section 271(1)(c) (sic.--271) has been inserted. As per this clause, it is not necessary for the AO to record his 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 Ms. Madhushree Gupta Vs. Union of India (UOI) and Another, 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:

19. In the result, our conclusions are as follows:

(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 AO 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 AO that the case may deserve the imposition of penalty should be discernible from the order passed during the course of the proceedings. Obviously, the AO 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 AO 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 AO since penalty proceedings are not a continuation of assessment proceedings [See Jain Bros. and Others Vs. The Union of India (UOI) and Others,

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

(vii) The proceedings for initiation of penalty 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.

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 reflect every item, viz., addition or disallowance yet we have to find out that the order is couched in such a manner and the discussion therein 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 u/s 80O 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 u/s 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 particulars of income or furnished inaccurate particulars. However, it shows that during the assessment proceedings, the AO found that the assessee had claimed deduction u/s 80O of the Act @ 50 per cent of its gross income earned in foreign exchange and not @ 50 per cent 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, refused to do the needful even when the case was adjourned repeatedly. Under such circumstances, the AO asked the assessee to explain as to why the expenditure relatable to 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. 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 a/c that expenditure of Rs. 38.03 lacs has been incurred on travelling, Rs. 6.83 lacs on consultancy fee, Rs. 26.72 lacs on communication and Rs. 9.32 lacs on training and development. These expenditures cannot be de-associated with the earning in foreign exchange.

(Emphasis, italicized in print, supplied)

The AO thereafter discussed the legal position relating to the deductions admissible u/s 80O 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 u/s 80O 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.

According to him, in these circumstances, the only alternative was to arrive at the net foreign income was to estimate such expenditure in the ratio of proportion of foreign income to the total income, which was 12.27 per cent. Thereafter, he calculated the eligible deduction u/s 80O, arrived at the taxable income, and observed that the penalty u/s 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 u/s 271(1)(c) were initiated by him. Thus, his prima facie satisfaction about non-furnishing of particulars/ inaccurate particulars is clearly discernible.

Re : Estimated disallowance u/s 80O:

The submission of the learned Counsel for the assessee in this behalf was that the AO while computing assessment u/s 80O of the Act allocated/apportioned Indian expenses debited in the P & L a/c 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 u/s 80O of the Act was made @ 50 per cent. The AO was not able to pinpoint any specific expenditure incurred in India, which was incurred in relation to foreign consultancy income. The AO merely resorted to an estimate to disallow part of the deduction u/s 80O 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 tinder Section 80O 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 Das,

(ii) Commissioner of Income Tax Vs. Ajaib Singh and Co., ; and

(iii) Harigopal Singh Vs. Commissioner of Income Tax,

In the aforesaid cases, it was held that where the assessee 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 u/s 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 have no bearing on the issue. The matter in issue in the present case is entirely different. The assessee for claiming deduction u/s 80O of the Act, wanted the same @ 50 per cent 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 u/s 80O, 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 u/s 80O 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 judicial opinion on the question of availability of deduction u/s 80O of the Act on gross or net income. The Tribunal has relied upon the decision of the Supreme Court in the case of Distributors (Baroda) Pvt. Ltd. Vs. Union of India (UOI) and Others, and the decision of this Court in the case of CIT v. Marketing Research Corporation (supra) in support of its conclusion that on the date of filing of return, the controversy was well-settled, viz., the deduction u/s 80O 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 u/s 80O had to be allowed on gross or net income. It is the settled proposition of law that deduction u/s 80O 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 per cent 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 Section 80O, as it stood prior to the amendment by Finance Act, 1974. The same had 410 application in the context of the provisions of the said section as applicable to the year under appeal. It was argued that despite this decision, the matter was referred to Full Bench by this Court in CIT v. Chemical and Metallurgical Design Co. Ltd. (2000) 161 CTR 317 (Del) . The judgment of the Full Bench in that case, which is reported as Commissioner of Income Tax Vs. Chemical and Metallurgical Design Co. Ltd., rendered on 15th Dec., 2000 that the issue was finally determined holding that in view of Section 80AB of the Act, deduction u/s 80O 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 u/s 80O 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 the claim of deduction u/s 80O of the Act, if the assessee had not adjusted the expenses incurred in India that was a bona fide 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) (P) 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 Sections 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 80O 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 Tribunal. 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 Sections 80O and 80M and, therefore, ratio of the Supreme Court in Distributors (Baroda) (P) Ltd. (supra) was not applicable while interpreting the provision of Section 80O of the Act, which is clear from the reading of paras 3 to 5 of the order of Division Bench in Chemical & Metallurgical Design Co. Ltd. (supra) referring the matter of Larger Bench. However, it would be interesting to note that this reference was made on 14th March, 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 u/s 80O 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 Supreme Court/jurisdictional Delhi High Court which is not in order and, in fact by doing so, the appellant has proved its guilty mind of deliberately furnishing inaccurate particulars of income to claim higher deduction and thus escaping the correct imposition of taxes. It is settled now that claiming excessive deductions also amounts 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 [ Commissioner of Income Tax Vs. India Sea Foods, (1938) 6 ITR 534 ), Commissioner of Income Tax Vs. Gates Foam and Rubber Company, . It is not right to say on the part of the appellant that the AO has to record the satisfaction before initiating the penalty proceedings u/s 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 AO.

12. The upshot of the aforesaid discussion would be to hold that the penalty was rightly imposed by the AO 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 AO

13. We, however, leave the parties without any costs.